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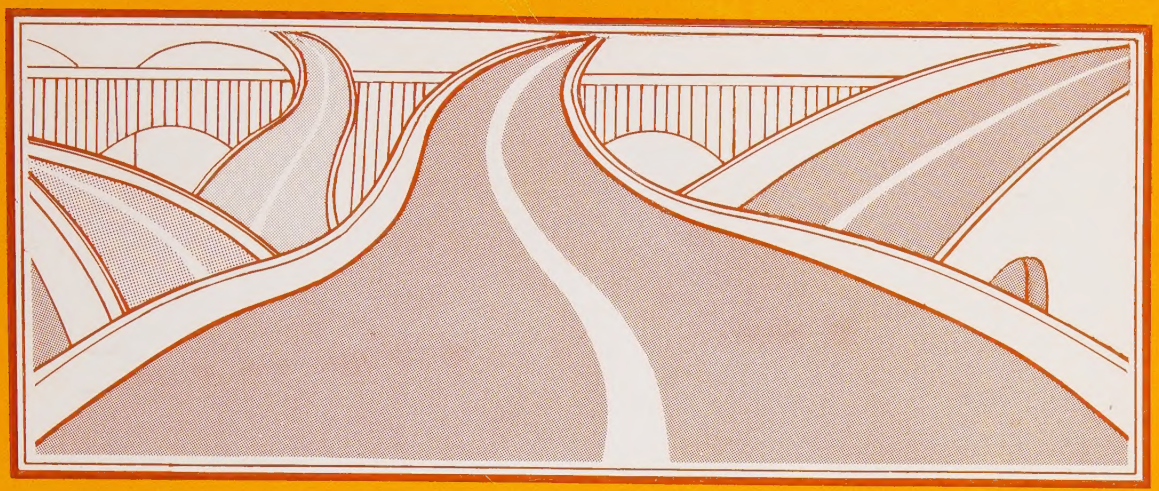

Renewing Our Infrastructure: Workable Ways to Build & Maintain Public Facilities

January 1983

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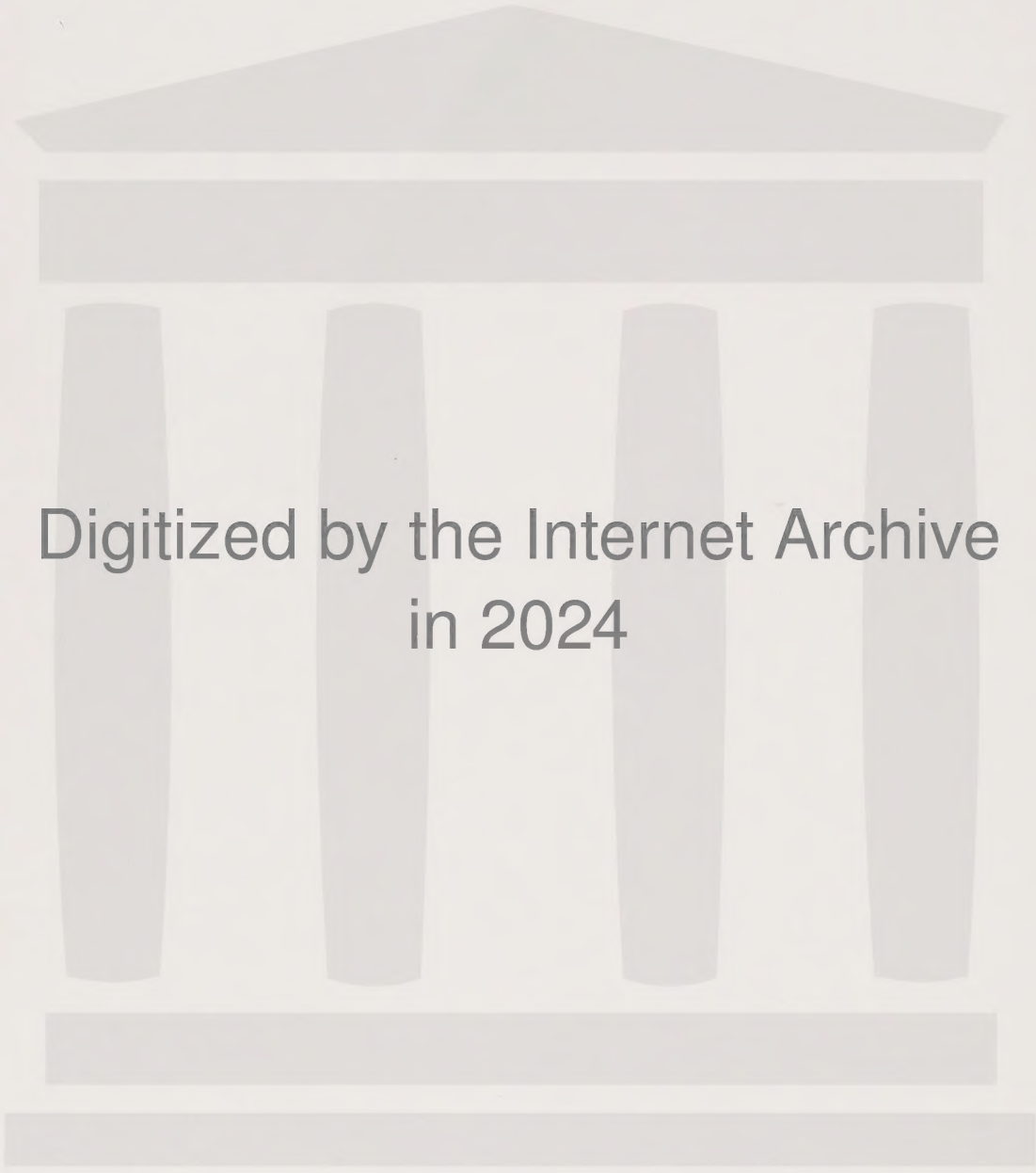
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RENEWING OUR INFRASTRUCTURE: WORKABLE WAYS TO BUILD & MAINTAIN PUBLIC FACILITIES

January 1983

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TABLE OF CONTENTS

1. Introduction 1
2. Background on Regional Growth 3
3. Bay Area Infrastructure Issues 7
4. Local Government Fiscal Capacity 13

   Inset: Local Fiscal Resources 14
5. Financing Methods and Task Force Conclusions 25
6. Discussion of Financing Methods 31

   Inset: Sale and Leaseback 47
7. Analyzing Alternative Methods 51
8. References 71
9. Task Force and Staff Roster 75
10. Acknowledgements 77

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1. Introduction

The San Francisco Bay Area's public facilities--its roads, sewers, wastewater treatment plants--are wearing out. During the 1960s and 1970s, local governments and the private sector were concerned about building new facilities to serve the rapidly growing population, and little attention was paid to the potential long-term costs of maintaining these facilities.

Because the Bay Area is a growing region, we still have to worry about how to pay for public facilities critical to our future growth. But we must also devote significant attention to maintaining what we've got at an acceptable level. The Bay Area shares this problem with almost every urban area in the country, although the infrastructure maintenance needs are probably not as critical in the Bay Area as other older urban regions of the country, principally in the Northeast.

Nevertheless, here are a few examples to illustrate the problem we face in the Bay Area:

- Streets in one Bay Area jurisdiction are scheduled for replacement once every 200 years--even though they'll wear out in 35-40 years.

- Driving over substandard pavement boosts tire wear by as much as 150% and fuel consumption by as much as 56%, according to estimates of a national highway research agency. American consumers in 1980 shelled out more than $6 billion in extra vehicle repairs because of driving on rough roads.

- Bay Area transit operators will need more than $2.1 billion over the next 15 years to replace buses, train cars and related facilities, according to estimates prepared by the Metropolitan Transportation Commission. Add to that figure the costs of needed improvements and expansions, and the Bay Area needs $3.7 billion. MTC estimates that only $2.3 billion may be available. The shortfall is staggering.

- Local street and road maintenance budgets were about $100 million short in 1980-81 of what they should have totalled, according to MTC. In constant dollars, actual expenditures for maintenance of local streets and roads that year was about 40% of the level spent a decade earlier.

- Residents of some cities have been advised to clean out debris from storm drains because the cities can't do the job given current budgetary conditions.

- To provide wastewater treatment for the population level projected for the year 2000, the Bay Area should be spending more than $240 million a year in capital and operation and maintenance costs. Actual expenditures are nowhere near that level.

Nationwide, critical problems such as these have gotten so bad that a recent publication of the Council of State Planning Agencies calls the situation "America in Ruins."

Business shares with the public sector a growing awareness of the difficulty of sustaining an economy at a time when local infrastructure is "decaying"--to use the words of a recent report by Business Week magazine. The problem is "far more severe"--calling into question the "ability of local governments throughout the nation...to provide the infrastructure needed for economic growth."

A task force of the American Public Works Association recently estimated that the cost of rebuilding America's infrastructure could reach $3 trillion--just at the time government at every level is seriously strapped for funds to pay for current services.

To address this problem, the Association of Bay Area Governments and the Bay Area Council, in cooperation with SRI International, formed a Public/Private Task Force on Infrastructure Funding. This joint effort recognized that both the public and private sectors have a stake in ensuring that the Bay Area's existing public facilities are maintained at a reasonable level, and that required new facilities are built to accommodate the population and job growth projected for the region. This report represents the initial findings of the Task Force.

In addition to the major conclusion that the Bay Area's existing infrastructure is deteriorating, the Task Force has concluded:

- Local government revenue raising ability has been constrained by the voters, but there are still options available to help maintain existing facilities, and to pay for new facilities.

- The options can be pursued by local governments in cooperation with the private sector. They are not necessarily conventional. Other conventional methods can be used more widely or in new and experimental ways.

The options discussed in this report are admittedly patches--even in combination they will not produce the funds necessary to maintain the existing infrastructure or support the growth projected for the region.

The Task Force believes that other more fundamental choices are probably necessary. These involve improving the processes of public investment decision-making (strengthening local capital improvements programming) and changing the ways public services and infrastructure are financed. These solutions are not so easily agreed upon or implemented by public and private sectors. This report, therefore, should be viewed as the start of a continuing dialogue among Bay Area local governments and the private sector on how to pay for local capital improvements without which the region will stagnate and then decline.

2. Background on Regional Growth

This section discusses certain key assumptions about future development of the region. These are critical to understanding the difficulty of providing infrastructure (sewers, sewage treatment capacity, streets and roads, schools, and other public facilities) and maintaining it. The discussion is intended to illustrate the magnitude of the problem and its relationship to the further maturing of the Bay Area as a major urban region.

A literature study prepared for the U.S. Department of Housing and Urban Development and the National Science Foundation in 1977 outlined the linkages between capital improvements and development activity. The review reflected "the assumption that certain public capital improvements, especially transportation facilities and sewers, have a significant influence on the nature and timing of development.

The study found that, despite the lack of rigorous empirical analyses:

> ...common sense, experience, and informed observation continue to lead researchers to attempt to find definitive proof of what is generally believed to be the case: that capital improvements do indeed influence private decisions to invest in communities. The precision and conclusiveness of empirical studies vary....
>
> The literature suggests that development is most closely correlated with linear facilities--utilities (interceptor sewers and related treatment plants and wastewater distribution systems) and transportation (highways and major transit facilities). These are generally considered the "critical" facilities without which development is unlikely to occur and, conversely, which can be used to influence the nature, timing, and location of development....

Examples cited in the study included:

- trunk sewers and wastewater treatment facilities
- water supply and distribution systems
- highways
- public transportation facilities
- open space
- other community facilities.

Lack of these facilities may prevent an urban region or local jurisdiction from accommodating growth deemed by policy-makers to be publicly acceptable or desirable.

The Bay Area's local governments through ABAG have adopted policies reflecting a commitment to orderly growth in the region. There is no question that the provision of public facilities is critical to future growth in the region. The Bay Area shares this problem with almost every urban area in the country.

Growth of Population and Housing

In 1980 the nine Bay Area counties had a population of about 5.2 million, living in more than 2 million housing units. By 1985, according to ABAG estimates, the Bay Area can expect a population of 5.4 million, living in 2.3 million housing units. By the year 2000, there will probably be about 6 million people.

These projections have major implications for the way public services are planned and delivered by the numerous government agencies involved--particularly at the local level. ABAG's most recent report on population, employment and housing trends in the Bay Area is Projections 79. As stated in that report, residential densities will have to change after 1985 (from the level being built between 1975-1980) or anticipated population and job growth is not likely to be accommodated in some places. **On balance, if densities are not changed sufficiently, then land not now assumed to be developable will have to be made available for residential purposes and infrastructure planned and financed, or the Bay Area will make a de facto decision not to grow beyond a certain point--of a magnitude yet undefined.**

Employment Opportunities

Job growth and the geographical distribution of employment opportunities (current and future) is a key factor in determining the infrastructure needs of the Bay Area--not only because of the effect of employment growth on population trends in the region, but also because of the infrastructure needs of industry.

In 1980 the Bay Area had slightly more than 2 million employed residents. ABAG estimates that employment will grow by 1985 to a level of 2.6 million, and to 3.4 million by the year 2000.

The growth pattern projected is part of an overall national trend showing increasing automation in manufacturing, slowdown in the growth of population and income, and rising labor force participation. The Bay Area, however, is expected to improve its relative position in the national economy, with increasing shares of employment in key growth industries--notably the finance, insurance and real estate sector, and the business services sector, with an annual average growth rate of 2.3%. High technology industries are expected to grow at more than 6% annually.

Previous ABAG reports, particularly Projections 79, implied that the region has a plentiful supply of industrial land reserved for future development activity. Based on more recent information--notably the employment forecasts discussed above--such implications must be reexamined.

Nevertheless, it is possible to conclude now that a **substantial portion of the 1975 industrial land reserve will be needed to accommodate projected employment growth through the year 2000.** Therefore, local governments planning policy changes that would accommodate residential growth by rezoning industrial land should do so

cautiously. Existing infrastructure may serve either industrial or residential growth, but urban expansion for either purpose will require new public investments. Rezoning industrial land for residential purposes now may cause future capital needs to be greater than might otherwise be the case.

3. Bay Area Infrastructure Issues

The magnitude of the financing required to provide and maintain the necessary infrastructure to accommodate growth in the Bay Area is not known precisely. With the exception of local street and road needs, little capital requirements information is available. Preparing such a regional capital improvements estimate for an urban area the size of the Bay Area would be an enormous undertaking--particularly because of the number of agencies that would have to be involved.

Despite the limited data, it is possible to describe in general terms the infrastructure needs for the most commonly cited facilities.

Wastewater Treatment Facilities

Provision of wastewater treatment has been a major capital expenditure for the San Francisco Bay Area. Pollution of San Francisco Bay--especially from poorly treated or untreated sewage--was a leading factor in the passage of the State's first water pollution control act in the 1940s. Following passage of the Federal Water Pollution Control Act Amendments of 1972, the construction of improved sewage treatment facilities stepped up considerably--largely because the Federal government paid 75% of the eligible construction costs.

The State of California puts up another 12.5% of the construction costs of sewage treatment facilities under the s. 201 program. Thus local governments contribute only a small share of these capital improvements. The local share of the construction cost together with the cost of operation and maintenance was to be financed, according to Federal law, by user charges (fees charged homeowners and businesses for use of the system).

The Federal government's willingness to pay such a large fraction of wastewater treatment facility construction costs was applauded by those in state and local government who believed in the principle that the level of government imposing mandatory duties on other levels of government should pay for the costs of complying with such mandates. On the other hand, the Federal government's capital investment for such a long period did not encourage state and local governments to consider ways to finance wastewater treatment facilities if, at some point, the Federal government decided to end national support for construction of such facilities.

By 1975 in the Bay Area, the construction of wastewater treatment facilities had required an investment of more than $2 billion. As part of the development of the region's Environmental Management Plan, adopted by ABAG in 1978, it was estimated that an additional $240 million each year would be necessary to pay for new plants and operate all wastewater treatment facilities. Not all of the projects associated with these estimates were Federally required under the Water Pollution Control Act but ABAG included them in the list of wastewater treatment "needs" in case eligibility regulations changed.

It is now apparent, however, that the Federal government is unlikely to provide financial assistance for wastewater facilities very much longer. In 1981 Congress reauthorized the construction grants program for a few more years, with reduced funding and redefined eligibility categories. In addition, EPA is considering reducing treatment requirements, although whether such requirements can be relaxed while meeting water quality standards remains unclear.

California can expect to receive only between $160 and $188 million annually through FY 1984 from the $2.4 billion program enacted by Congress in 1982. New capacity for growth in urban areas may have to be provided entirely by local funds. State funds will probably not be made available to treat new capacity after 1985. Certain restrictions have been enacted by the State Water Resources Control Board to make funds available to complete existing, incomplete projects. The state estimates that more than $1 billion will necessary to complete projects now under way.

Local Drainage

The first national attempts to estimate the financial costs of stormwater control were made by the National Commission on Water Quality in the mid 1970s. It was evident that the costs of treating runoff would be astronomical--about $200 billion in 1974 dollars.

There exist no reliable estimates of Bay Area expenditures for storm sewer collection systems or their maintenance. Such an analysis is beyond the scope of this brief report. However, the situation in Oakland may illustrate the nature of the problem.

Oakland imposed a sewer service charge in 1962--less than $1 per month per household. It was then believed that revenues would enable the city to adhere to its optimal replacement cycle of 60 years. However, inflation has dramatically diminished the financial resources of the storm sewer program. Between 1968 and 1980 the basic monthly charge remained constant at $1 per month, having been raised to that level in 1968. During the same period, according to the Public Works Department, operating and capital costs more than doubled. In 1980 the city raised the sewer service charge to $1.50 per month, and city officials estimated it would provide an additional $1 million annually. But they doubted the increased revenues would cover both operating costs and capital replacement for more than a few years. The shortfall is expected to be considerable by 1985, and the city is taking steps to raise the charge again.

Maintenance of these facilities is also a problem. The inability of local governments to maintain existing facilities has contributed to erosion and sediment problems, particularly in hilly and developing areas. Most local agencies do not have adequate erosion control programs, and this contributes to overtaxing the existing drainage network. During storms last winter, Oakland residents were warned to take the initiative to make sure storm drain areas were clear. ABAG has estimated that local governments spent $7 million in 1980 cleaning sediment from streams, channels and reservoirs. Another $14 million was spent dredging San Francisco Bay. Sediment removal costs were estimated at $65 million if all sediment were to be removed from Bay Area waters.

None of these figures included storm drain sediment removal, which could easily double the amount that needs to be spent.

Local Streets and Roads

The declining condition of local streets and roads has been apparent for some time. The problem is most striking in the large cities of the State. In Oakland, for example, the life cycle of a street in 1977-78 was reported at 25 years; one year later the city estimated a street replacement cycle of 98 years. Last year, city officials estimated Oakland was approaching a 200-year replacement cycle.

Due in large part to a concerted effort to make State legislators aware of the deteriorating condition of streets and roads, the California Legislature in 1981 enacted the first increase in state gasoline taxes since 1963. SB 215 is estimated to produce an additional $59 million for cities in 1982-83, and approximately $100 million for subsequent years. These amounts are allocated on the basis of population. In addition, the State Highway Account will receive an additional $216 million for 1982-83 and more than $300 million thereafter. In addition to these figures, it is estimated that another $89 million will be made available to cities through the year 1985-86 through the transportation development program--administered by the regional transportation agencies.

SB 215 also included authority for levying, with voter approval, an increase in the gas tax based on agreements between a county and cities within it to put such a measure on the ballot. Although officials of several Bay Area counties and their cities have contemplated asking voters to approve this increased gasoline tax, no proposition has been scheduled for the Bay Area.

Most observers believe the provisions of SB 215 will not provide the financial resources to keep pace with the increasing maintenance costs of the existing transportation system and additions to it, although the law makes maintenance and rehabilitation of the existing system the first priority for the 1982 State Transportation Improvement Plan.

The Metropolitan Transportation Commission has conducted a review of Bay Area local street and road needs based on a comprehensive analysis by local public works officials. MTC prepared two reports. The first contained information on the size and age of the existing system, an analysis of maintenance expenditure trends, and an analysis of what is required for adequate maintenance. The analysis showed that in constant dollars (adjusted for inflation) local governments were spending 60% of that spent a decade previously for maintenance. In FY 1980-81, Bay Area cities and counties spent $167 million to maintain their 11,000 miles of city streets and 6,000 miles of county roads--compared to a total of $268 million required to keep the system in adequate condition, creating a $101 million revenue gap. Most of the shortfall was in the critical area of preventive maintenance. This "deferred" maintenance is causing a backlog of maintenance requirements, which was documented in the second MTC report. The expenditures needed to bring the roads back to an acceptable standard were called "backlog" costs.

Among the specific findings from the two-report study were these:

- In the area of cyclical or preventive maintenance, Bay Area jurisdictions were budgeting only $42 million against the estimated need of $118 million, or 1/3 of what is needed.

- Maintenance requirements will increase substantially in the next decade. Many of the Bay Area's streets and roads are reaching the point when more expensive preventive maintenance treatments such as overlays should be applied. Cyclical maintenance needs will rise from $118 million in 1980 to $171 million in 1990, even without taking into account inflationary increases.

- SB 215 revenues will provide only about one-third of what was estimated as the street and road maintenance shortfall.

- Cutbacks in preventive and routine maintenance have led to increased costs to bring roads back to adequate condition. The overall Bay Area maintenance backlog was estimated at between $300 and $500 million.

- Approximately 20% of more than 1,500 miles of streets and roads in the 11 Bay Area cities and counties actually surveyed were classified as in fair to poor condition. Of these 300 miles, three-fourths were in sufficiently poor condition to require overlays, and the remainder had deteriorated to the point where restoration was required.

- The effects of deferred maintenance are more severe in older cities and counties, since older pavement deteriorates at a faster rate than new pavement. For example, the regional average for pavement requiring overlays or restoration is 20%; for Berkeley 46%, and for Oakland 49%. Berkeley's problems are very severe--27% of its roads have deteriorated to the point where restoration is required.

Water Supply

Through the year 2000, the Bay Area is likely to have all the water it needs to support a growing, urban population, although there may be shortages in certain parts (principally in the North Bay). The basic water supply storage facilities are in place or planned in the near future. It is unlikely that new capital investments will be required for large storage facilities not already identified. However, capital investments for delivery pipelines will be required; most water agencies appear to have this need for capital under control.

In addition, major water agencies in the Bay Area are in the process of analyzing the feasibility of major interties among districts to aid in the distribution of water should 1976-77 drought conditions reoccur in the region between now and the year 2000. These agencies are identifying where such interties might be located in order to assess the feasibility of construction and its institutional, social and economic consequences, but have not progressed to the point where the capital investment requirements can be stated. Replacement costs for existing facilities cannot be estimated at this time.

Statewide, the Department of Water Resources has estimated through the year 2000 as much as $7 billion could be required for new water supply facilities, including transportation networks, and repair of existing facilities.

Schools

According to an estimate by Kevin Bacon, former consultant to the Assembly Office of Research, California needs approximately $2.5 billion in identified school rehabilitation and replacement, and new construction costs.

After enactment of Proposition 13 (although pre-Proposition 13 voter-approved general indebtedness is not subject to rate limitations), local school districts have been unable to issue bonds or participate in a state school construction loan-program. The Legislature, in response, enacted a new school lease-purchase program. Proposition 1, enacted by voters in November, authorizes $500 million in state general obligation bonds to provide funds for new schools under the lease purchase program. No more than $150 million can be spent modernizing existing schools.

While many school districts in the state have declining enrollments, others do not, and new schools are needed. Where enrollments are declining, schools have been closed. In many districts, decisions to close schools have been made with little or no attention to probable increases in enrollments in the future. Surplus school sites in the Bay Area and elsewhere have been considered as potential sites for new housing or other non-school uses. It is not clear how much consideration has been given to the potential need to retain such facilities; demographic information about the potential Bay Area-wide need for school facilities 15 years or so from now has not been systematically reviewed as part of an overall capital requirements program. No Bay Area information is presently available regarding the volume of deferred maintenance of existing facilities. What is known is that virtually every district with budget constraints is finding it necessary to defer needed maintenance of their school facilities.

Courts and Jail Facilities

Bacon has also estimated a need for $1 billion in local court and state and local jail construction. Bay Area estimates of such need have not been prepared. Bacon's report prepared for the Assembly Office of Research noted that counties are subject to licensing and capacity standards set by courts or Federal and state law, leaving little flexibility in meeting capital requirements.

In June 1982, California voters approved $495 million in bonds to enlarge the state prison system. In November voters approved Proposition 2, which would authorize the state to sell $280 million in state general obligation bonds for construction and repair of county jails. The counties are required to provide $70 million in matching funds, with bond proceeds allocated by the State Board of Corrections. Thus for local jail modernization, local agencies may be heavily dependent on the state.

4. Local Government Fiscal Capacity

California's local governments are finding it increasingly difficult to provide services the public has traditionally demanded and (prior to the enactment of Proposition 13) been willing to pay for. Virtually all cities and counties in the State have experienced substantial problems in providing public services and facilities--some even before Propositions 13 and 4. The inset on pages 14-24 describes the local fiscal structure in more detail.

There is no need here to review extensively the effects recent tax revenue and limitation measures have had on Bay Area local governments. Although not every local government has serious problems, many have been severely weakened by revenue losses and declines in Federal and State assistance and by inflation.

Local governments face revenue limitations imposed constitutionally (e.g., Article XIIIA) or by statute (e.g., sales tax rates set by the State, limitations on local government development fees). In addition, as Federal and State governments seek to reduce spending, they tend to look first at cuts in grants in aid to local agencies. Examples of this are the Federal consolidations of grant programs into community development block grants, coupled with overall reductions in expenditures, and cuts in certain local government subventions.

The prospects for improvement in the fiscal condition of many Bay Area cities are not good. In general, local elected officials believe it will be some time before the situation improves significantly. Additional revenue raising capability will have to be part of a concerted, Statewide effort. Until this is done, revenue problems in many jurisdictions will be particularly acute.

Federal funds available to local governments are decreasing. Grants are expected to fall from a 1980 level of $88 billion to $78.6 billion this year--a significant decline in real terms. Given the State's worsening fiscal condition, local governments cannot look to Sacramento for increased State assistance.

Use of newly authorized general obligation bonds was virtually eliminated by Proposition 13. Interest rates have drastically affected the ability of local governments to borrow, and local bond issues--even if they could be issued--are not attractive to investors as long as the State imposes interest rate limitations considerably lower than those of private issuers.

LOCAL FISCAL RESOURCES

This inset briefly describes the basic structure of local government revenues and expenditures. The information presented is for either the 1979-80 or 1980-81 fiscal year, based on annual reports published by the State Controller.

The figures cited are average and do not show the level of expenditures or revenues for individual jurisdictions. While individual communities or districts may differ from the patterns shown, in general the relationships shown in the figures are valid.

County Revenues

Figure 1 summarizes the sources of revenue for counties in California (excluding San Francisco). The 57 counties raised approximately $9.3 billion in 1980-81, an increase of 15% from the 1979-80 level. The figure is exclusive of enterprise and bond funds. Enterprise revenues totaled approximately $1.4 billion for such activities as hospitals, airports, parks, golf courses and parking.

The figure also shows the heavy dependence on intergovernmental transfer payments from Federal and State governments. On average, county governments received 60% of their revenues from Federal and State grants and subventions. Most of these funds are for health and welfare programs.

County Expenditures

Expenditures for the 57 counties totalled $9.4 billion in 1980-81, an increase of about 15% from the 1978-79 level. Approximately 3% was for capital outlays, and 0.3% for debt service. Bonded indebtedness was $75 million--about 0.05 percent of net assessed value of the counties.

The average distribution of county expenditures by function is shown in Figure 2.

City Revenues

California's 426 cities in 1980-81 received, exclusive of enterprise and bond revenues, approximately $7.2 billion. This was an increase of 11% from the 1979-80 level.

Approximately 29% of city revenues, on average, came from Federal and State grants and subventions. Sales and use taxes were the second highest revenue source (18%), followed by property (14%) and other taxes (13%).

The general city revenue picture is shown in Figure 3.

City Expenditures

Cities spent about $6.9 billion in 1980-81, more than 8% higher than the previous year. Figure 4 shows the general expenditure pattern for cities by function. Compared to counties, cities had significantly higher proportions of their expenditures for capital outlay (11.4%) and debt service (2%).

Public safety activities were the single most significant functional expenditure category, with police protection accounting for 23 cents of each dollar spent, and fire protection accounting for another 12 cents.

Total bonded indebtedness for cities rose to the $4.8 billion level--with about four-fifths of that in revenue bonds. While total indebtedness rose significantly (as shown in Figure 5), the level of general obligation bonds declined (because of Proposition 13), while improvement district bonds remained at the level they had been for the prior three years.

Special District Revenues and Expenditures

Figures 6 and 7 show non-enterprise special district revenues by source and expenditures by functional category. Enterprise special district revenues and expenditure are shown in Figures 8 and 9.

Figure 10 shows special district long-term debt by type of activity. Figure 11 shows transit district revenues and additions to equity through capital expenditures. Figure 12 shows transit district expenditures by type of activity and Figure 13 shows expenditures by type for non-transit operations of cities and counties.

Figure 1
General Revenues for California Counties

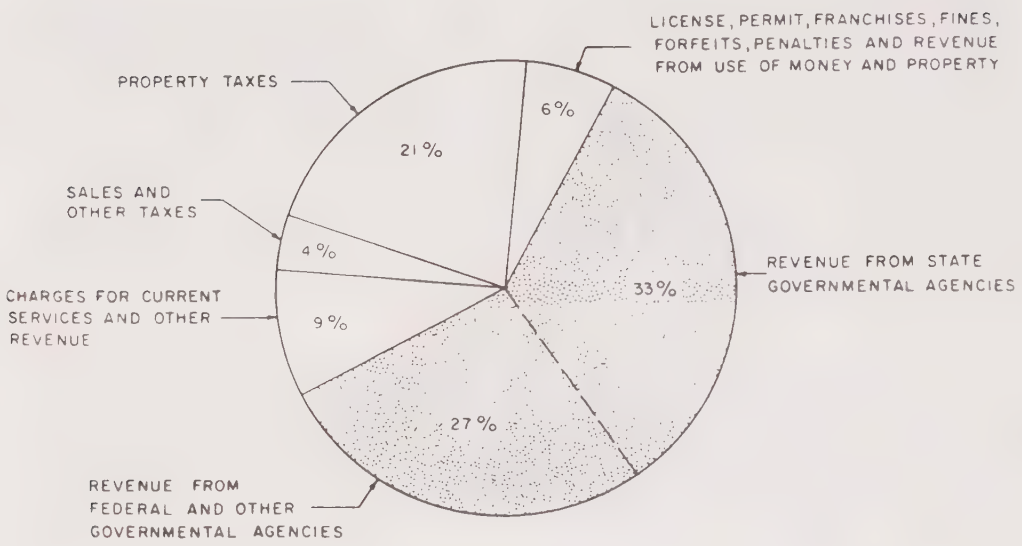
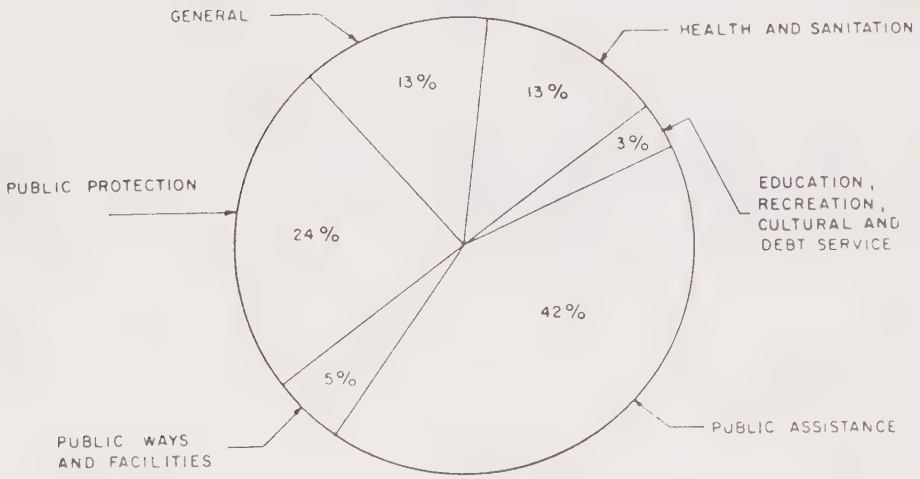


Figure 2
General Expenditures for California Counties



Source: State Controller, Annual Report of Financial Transactions, Counties, 1980-81.

Figure 3
General Revenues for California Cities

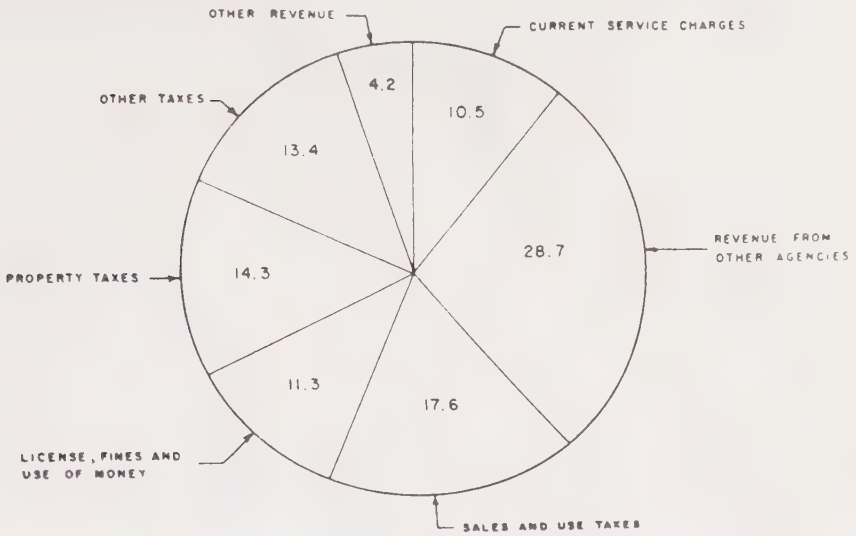
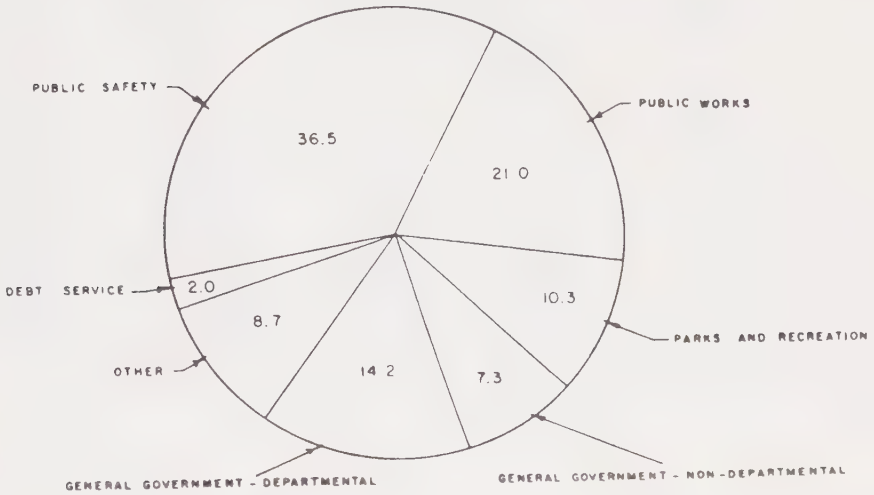
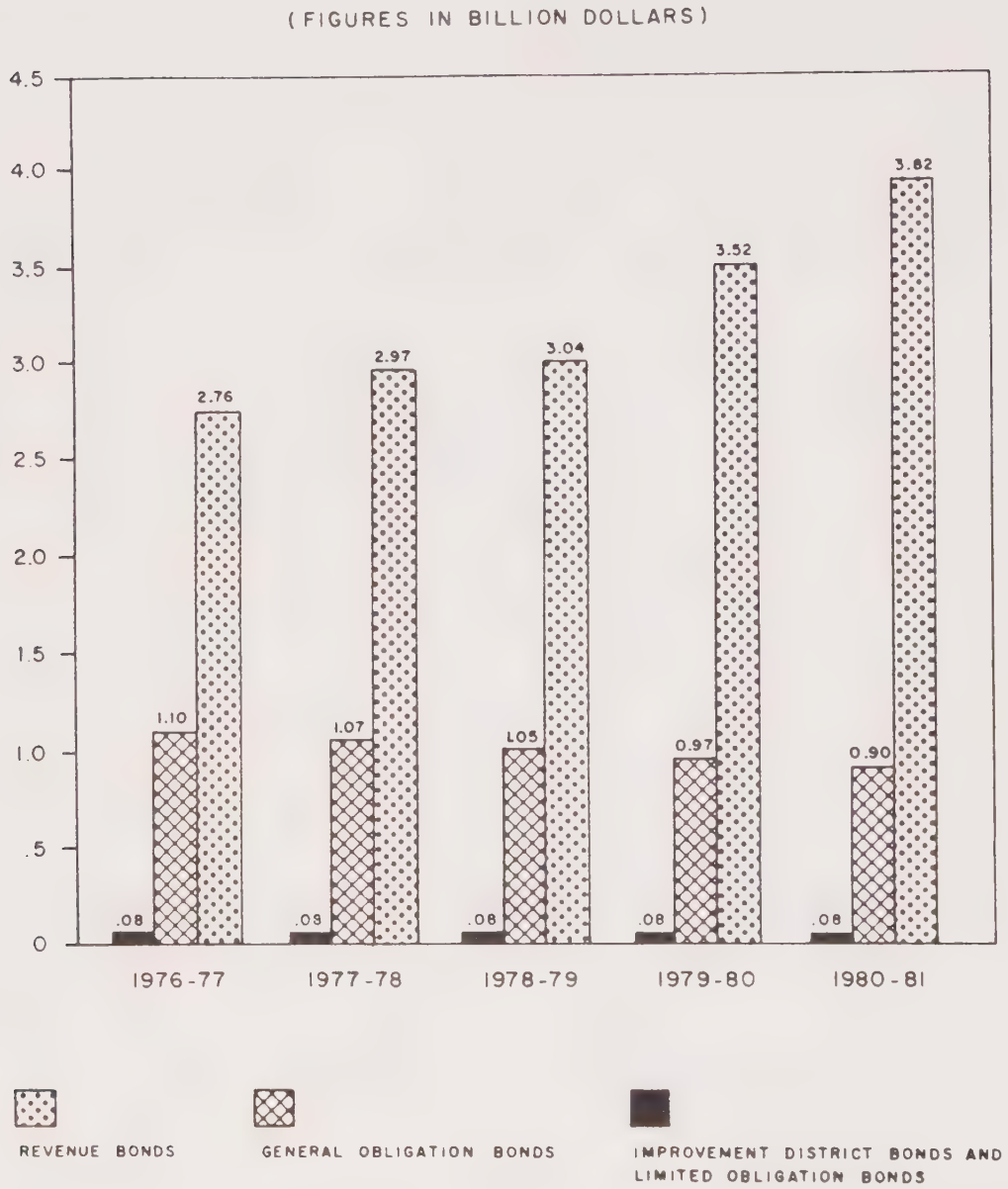


Figure 4
General Expenditures for California Cities



Source: State Controller, Annual Report of Financial Transactions, Cities, 1980-81.

Figure 5
Bonded Indebtedness for California Cities



Source: State Controller, Annual Report of Financial Transactions, Cities, 1980-81.

Special Districts of California
Non-Enterprise Activities, 1979-80

Figure 6
General Revenues by Source

$1,445,942,488

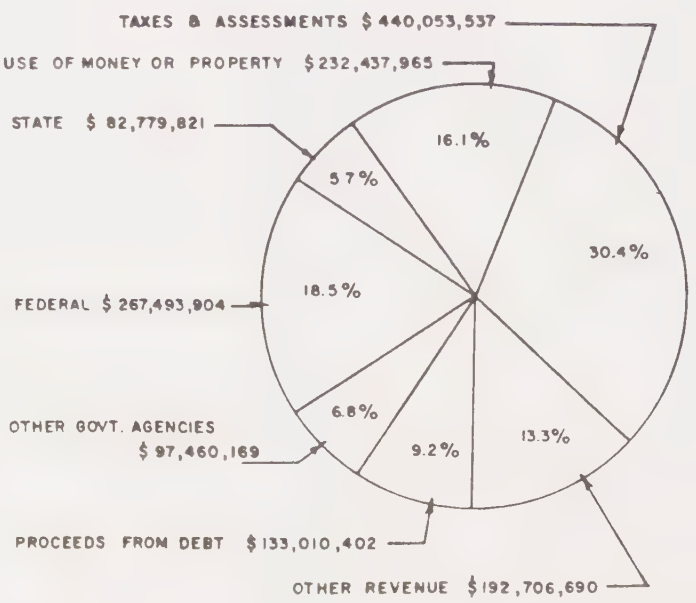
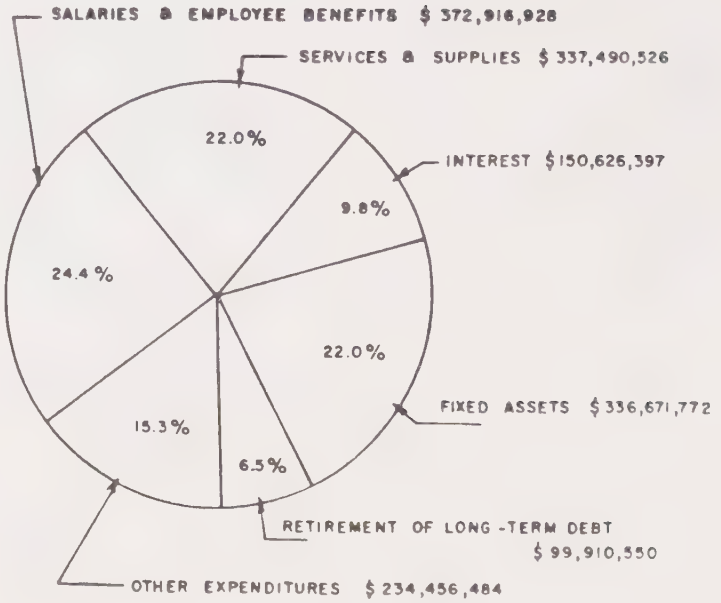


Figure 7
Expenditures by Function

$1,532,072,657

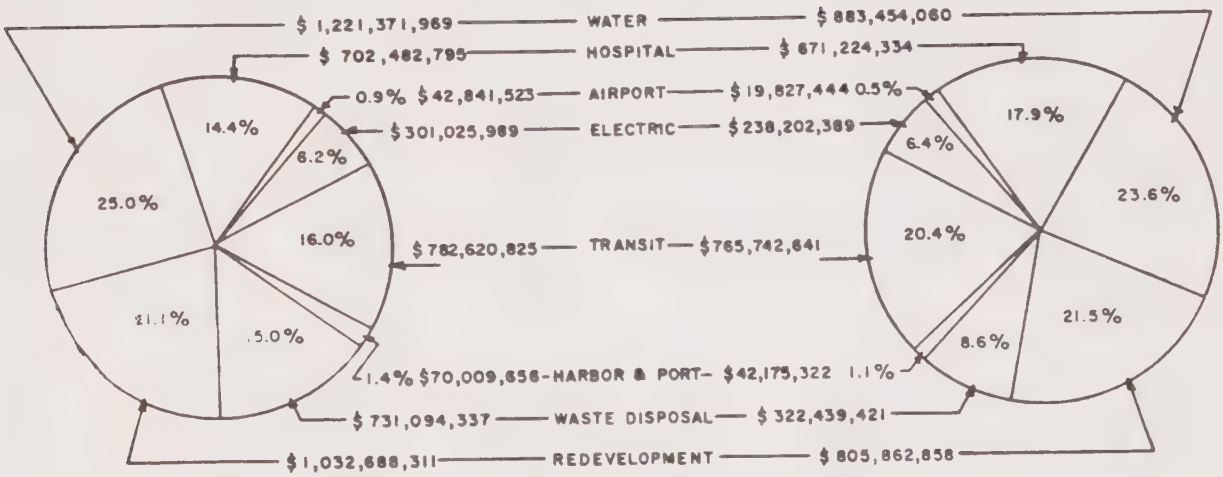


Source: State Controller, Annual Report of Financial Transactions, Special Districts, 1979-80.

Special Districts of California
Enterprise Activities, 1979-80

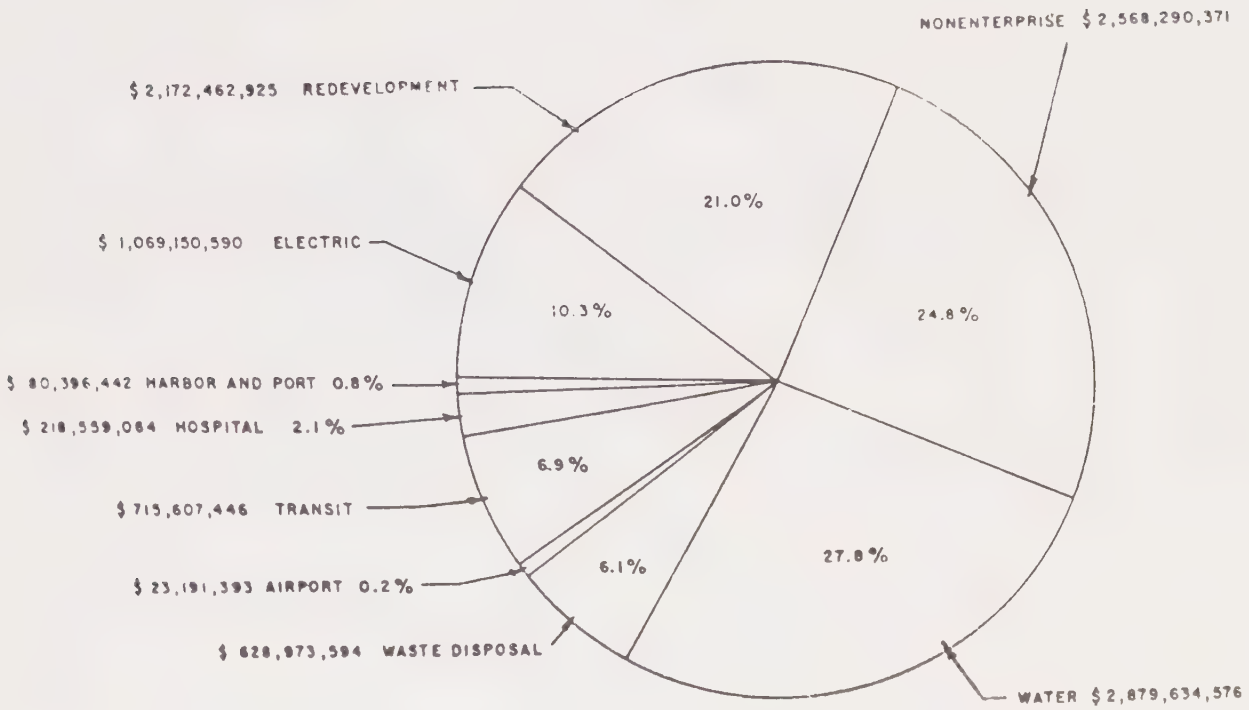
Figure 8
Revenues by District Type

Figure 9
Expenditures by District Type



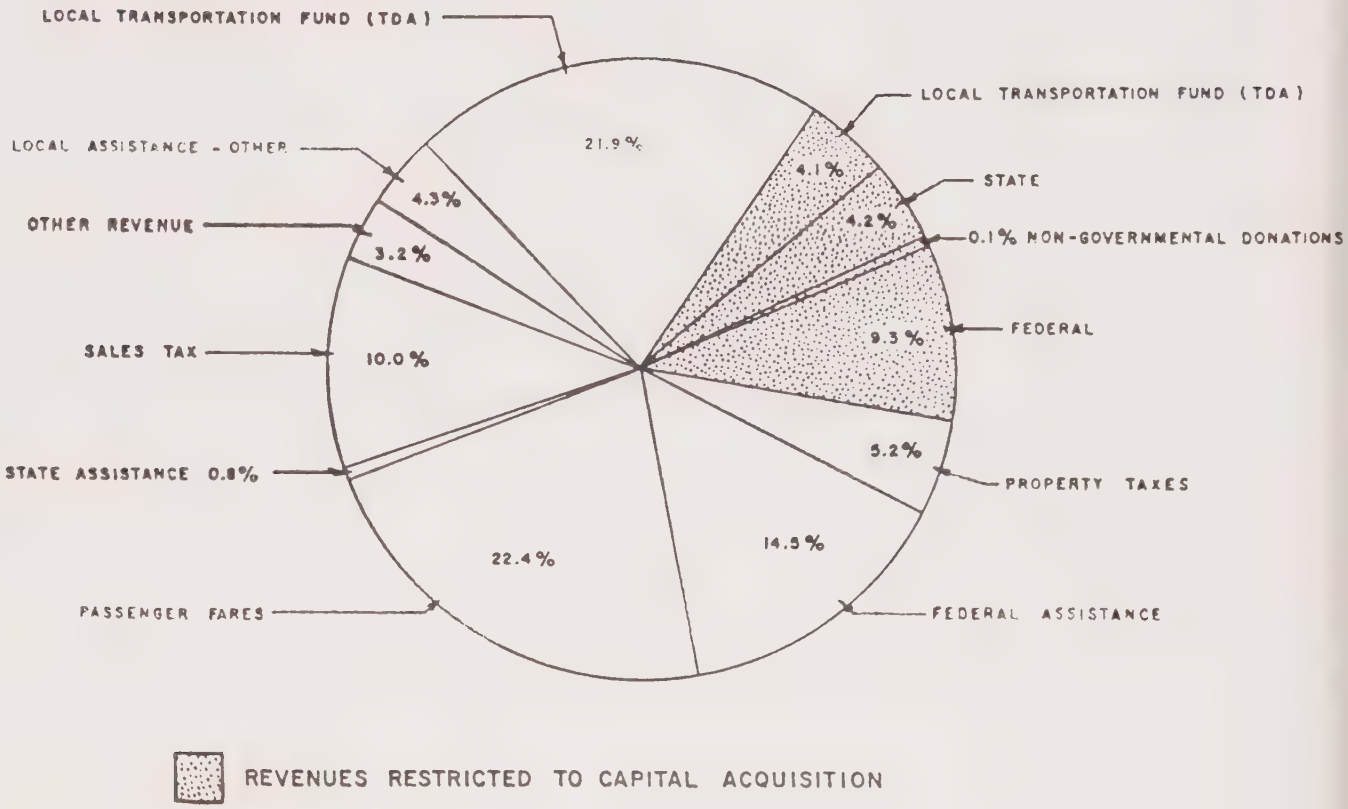
Source: State Controller, Annual Report of Financial Transactions, Special Districts, 1979-80.

Figure 10
Special Districts of California
Long-Term Indebtedness, 1979-80
By Type of Activity



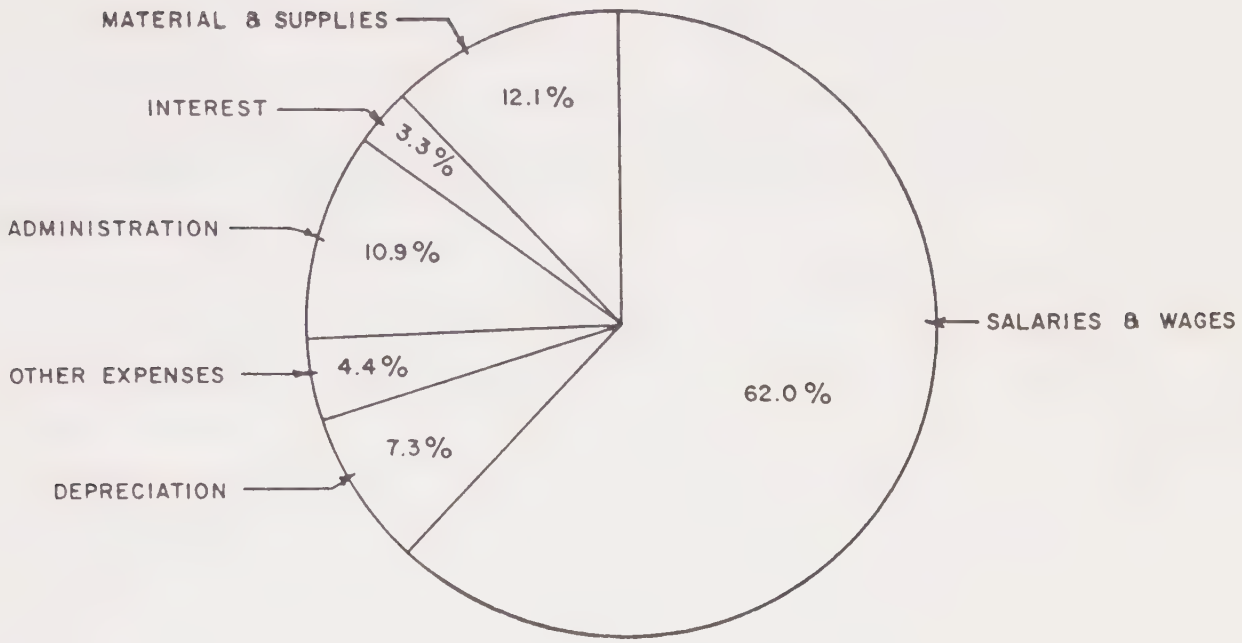
Source: State Controller, Annual Report of Financial Transactions, Special Districts, 1979-80.

Figure 11
Transit District Revenues and Additions to Equity
1979-80



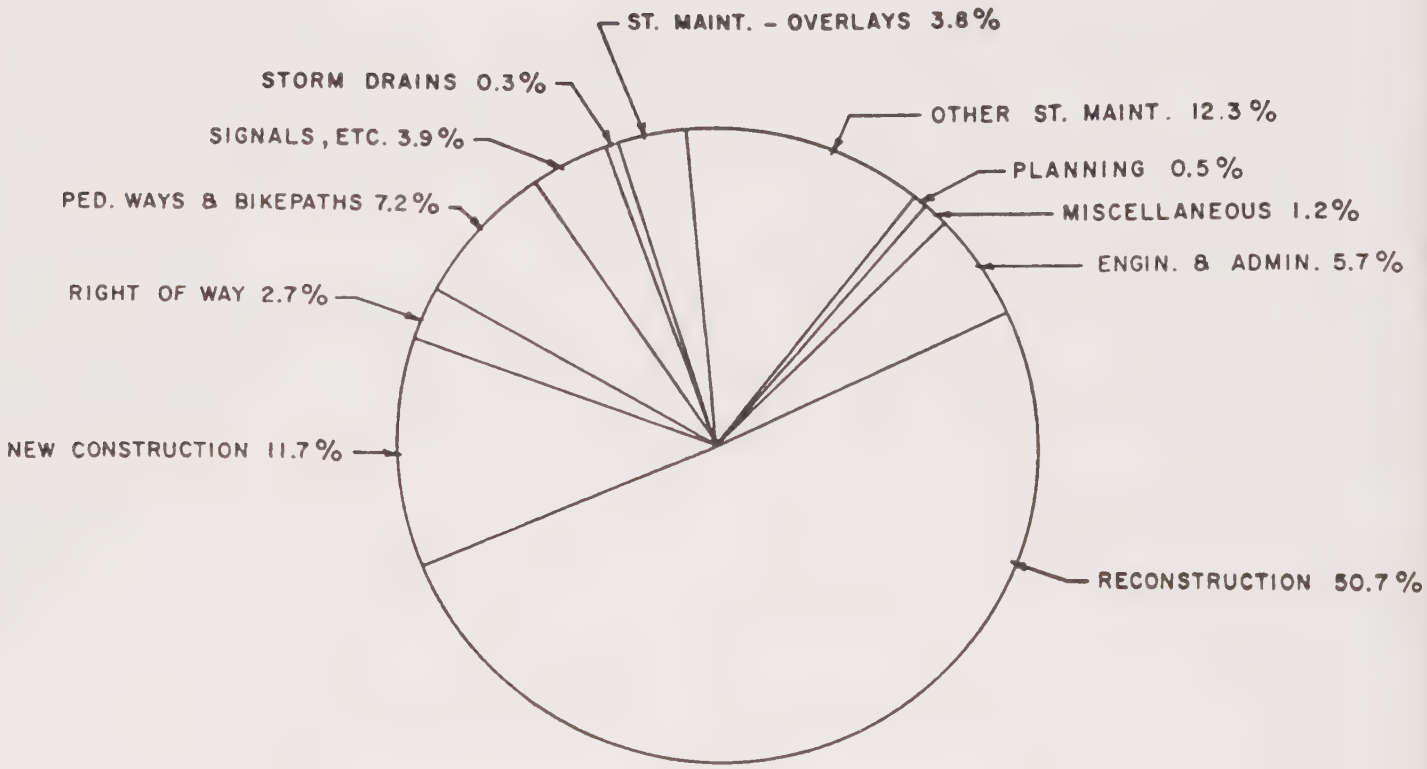
Source: State Controller, Annual Report of Financial Transactions, Transit Operators and Non-Transit Claimants, 1979-80.

Figure 12
Transit District Expenditures
By Type, 1979-80



Source: State Controller, Annual Report of Financial Transactions, Transit Operators and Non-Transit Claimants, 1979-80.

Figure 13
Non-Transit Expenditures
By Type, 1979-80



Source: State Controller, Annual Report of Financial Transactions, Transit Operators and Non-Transit Claimants, 1979-80.

5. Financing Methods and Task Force Conclusions

Previous sections of the report have briefly summarized the need to raise funds to build and maintain the Bay Area's public infrastructure. In examining questions of that need, and the existing capability of local governments to meet it, the Task Force undertook an examination of currently available funding possibilities. The financing methods were reviewed from two perspectives:

- Are there financing options available that are not used as extensively as they could be?
- Are there innovative ways to use conventional financing options?

The Task Force's examination produced a list of financing methods briefly identified below. While other options may exist, the Task Force believes those identified have the most potential for immediate use and experimentation in the Bay Area.

The Task Force concluded that the financing methods may properly be viewed as falling into three categories: revenue-raising, debt, and public-private approaches. Since some methods are easier to use than others, the methods most widely used or easier to use are listed first in each category.

As stated previously, the financing techniques discussed in this report will not, by themselves, solve the Bay Area's growing problem of degradation of public infrastructure. Fundamental changes in state tax laws and increased focus on capital improvements programming are probably necessary but are beyond the scope of the report.

Nevertheless, the Task Force believes the available remedies should be pursued vigorously now by the Bay Area's local governments, in cooperation with the private sector. Until more fundamental changes occur, these financing methods will be those most readily available to local governments to maintain our existing infrastructure, and to provide new facilities necessary to accommodate projected growth in the region.

REVENUE-RAISING METHODS

Development Fees and User Charges - A conventional approach to raising local revenues that is becoming more widely used.

Short-Term Money Management - Use of various investment techniques to produce maximum returns on local government funds.

Benefit Assessments - Involves paying for certain public facilities using geographical districts and determining property benefits and proportionate assessments.

Community Facilities Districts - Involves establishment of local districts to enact special taxes to pay for certain public facilities and services.

Redevelopment Authorities - A traditional approach to fund new construction in project areas using property tax increases from rising property assessments.

Independent Authorities - Joint delivery by two or more local public agencies of facilities or services, such as fire and police protection.

Special Taxes - A revenue source identified in Proposition 13 that local governments may use for specific purposes after approval by a two-thirds vote.

Motor Vehicle Fuel Taxes - Involves levying a countywide tax in 1-cent increments per gallon of gasoline, and after approval by voters, allocating the proceeds for local transportation purposes.

DEBT METHODS

Revenue Bonds - Now that general obligation bonds by local governments are limited to those authorized prior to passage of Proposition 13 in 1978, the most readily available and conventional way to finance public facilities.

Lease-Purchase Financing - A traditional approach to acquiring real property or equipment for public purposes.

Certificates of Participation Lease Financing - Involves the sale of certificates (representing interest in leases to public entities) to private investors to raise funds for new facilities. This method is often used in combination with sale and leaseback arrangements.

Creative Use of Bond Instruments - Involves unconventional or non-traditional aspects of bond financing, such as zero coupon or indexed bonds.

PUBLIC-PRIVATE APPROACHES

Charitable Contributions - Seeking contributions from citizens and the private sector for tangible public facilities and their operation and maintenance.

Private Enterprise Licensing - Involves granting exclusive rights to construct and/or operate certain facilities.

Public Sector as Entrepreneur - Involves local government operating as if the local government were a private firm; examples are municipal insurance programs and development of surplus property. This also could involve bargaining with developers to pay for certain facilities in return for public investment and development permits.

Sale and Leaseback - Involves the sale of newly constructed or existing facilities to private investors and leasing them back for public uses.

Based on its analysis, the Task Force has also concluded that certain financing techniques may more easily be applied to providing certain types of public improvements. Table 1 on the following page shows the applicability of the options to various public investment needs.

TABLE 1

APPLICABILITY OF INFRASTRACTURE FINANCING OPTIONS

NEED / OPTION	Waste Water	Local Drainage	Streets Roads	Water Supply	Schools	Transit	Courts Jails
Development Fees and User Charges	X	X	X	X		X	
Short-Term Money Management	X	X	X	X	X	X	X
Benefit Assessments	X	X	X	X		X	
Community Facilities Districts	X	X	X	X	X	X	X
Redevelopment Authority		X	X	X			X
Independent Authority	X	X		X		X	X
Special Taxes	X	X	X	X	X	X	X
Motor Vehicle Fuel Taxes			X			X	
Revenue Bonds	X	X		X		X	
Lease-Purchase Financing	X			X	X	X	X
Certificates of Participation Lease Financing	X			X	X	X	X
Creative Use of Bonds	X	X		X	X	X	X
Charitable Contributions	X	X	X	X	X	X	X
Private Enterprise Licensing	X			X		X	
Public Sector as Enterprenuer	X			X	X	X	
Sale and Leaseback	X			X	X	X	X

What Comes Next

This report has examined options available to local communities for financing infrastructure under current law. It is clear that while the ability to finance capital improvements through general taxes and general obligation bonds are limited, a variety of alternative methods of financing can also be considered. In the absence of fundamental reforms in public financing of infrastructure, local governments and businesses interested in capital improvement will have to be creative in developing strategies for development and maintenance of public infrastructure. Where can local leaders begin?

One major purpose of this report beyond drawing attention to the infrastructure problems of the Bay Area is to help local leaders assess the alternatives for addressing the problems. The discussion of options and the matrix evaluation of each alternative were designed to help provide guidance concerning the advantages and disadvantages of each option. The key issue is what option or set of options is most appropriate for a particular set of local circumstances. What works best for one community may not necessarily work for another. How do local leaders decide what is more appropriate?

Community Problem Solving

Developing a strategy for dealing with local infrastructure problems could involve the following basic steps:

1. Form a coalition of public and private leaders concerned about the issue

   Infrastructure problems affect both business and the community as well as government and most solutions involve the support and involvement of each sector. Early involvement of key leaders in a problem solving coalition can be critical for successful development of effective strategies.

2. Analyze the key elements of the local problem

   Is the problem one of maintenance and repair requiring better replacement schedules or one of construction of new facilities? What are the most critical needs?

3. Identify the possible alternatives

   Using the report and other similar analyses, develop a list of possible options for financing.

4. Evaluate the alternatives

   Using criteria similar to those in the report, determine what options are most appropriate for the community.

5. Develop a strategy for implementing the appropriate options

   Develop community support for adoption of the changes required (i.e., setting up a benefit assessment or community facilities district, adopting a special tax, passing new bond issues, or developing new public-private approaches).

This process could help identify appropriate strategies and build broad community support for adoption of the financing plan. It also would help to identify those actions that would need to be taken on a regional or state level. The approach suggested above is essentially a local community problem solving process that would seek solutions at the community level before moving to higher levels of government for assistance.

6. Discussion of Financing Methods

Section 5 summarized some policy options for financing Bay Area public infrastructure. In this section, the options are discussed in more detail, and summarized in a standard format. While there may be other methods available, the Task Force believes those reviewed here have the most potential for immediate experimentation and use in the Bay Area.

Development Fees and User Charges

Since the passage of Proposition 13, the fastest growing area of infrastructure financing has been fees, user charges and developer exactions. A 1981 analysis on local finances prepared for the Assembly Office of Research found a 39 percent increase in fees and user charges between 1977-78 and 1978-79. They accounted for approximately 8 percent of general city revenues in California in 1977-78. The next year, this category increased to 9 percent, and the following year to 10 percent of general city revenue--or nearly $620 million statewide.

The primary purpose of user charges, as noted in a recent monograph published by the University of California's Institute of Governmental Studies, are to:

- Defray the costs of providing goods and services
- Promote efficiency or cost minimization in local government.

There are several ways to design a user charge system, according to one advocate of a local government user charge system, Stanley Schoenfeld of Peat, Marwick, Mitchell and Co.:

- Cost-oriented--where prices are set to recover costs.
- Competition-oriented--where prices are influenced partly by what a user would pay to obtain the service from an alternative (usually private) source.
- Demand-oriented--where prices vary in relation to the number of persons who want the service in particular ways, at particular times, at particular locations, and so forth.
- Convenience-oriented--where prices vary to reflect value of the convenience of the service or the manner in which it is paid for.

- Societal method--where prices are adjusted to reflect objectives such as lower prices for senior citizens or higher charges to discourage nonresident use.

In California, the most important of these approaches is the first. Article XIII B of the State Constitution, enacted limitations on local government expenditures using "proceeds of taxes." The Constitution defines "proceeds of taxes" to include proceeds from regulatory licenses, user charges and user fees "to the extent that such proceeds exceed the costs reasonably borne by...[a local] entity in providing the regulation, product or service...."

As noted, a principal reason for levying user charges is to fund operating and maintenance costs, as well as replacement costs for certain types of facilities. A recent study performed by the General Accounting Office for Congress concluded that many municipal wastewater treatment plants were not raising sufficient funds from their user charge systems to cover operation and maintenance costs. Only a small percentage of the local governments surveyed in the study were setting aside funds to replace treatment plants when they reached their economical/technological life; many indicated they planned to return to the Federal government for replacement funding.

Implementation Considerations

The Task Force believes local governments can periodically examine the costs of providing certain services for which user charges and development fees are levied. To the extent that these charges do not reflect the actual or current costs of providing services, local governments can adjust their charges and fees accordingly. This activity would ensure that local government general funds do not subsidize services for which the local government might recover costs from users.

Short-Term Money Management

Local governments receive substantial sums of money to conduct their operations. As with private firms, not all funds are to be used at one time; these so-called "idle" funds can be invested by public agencies in the financial market place. Since short-term money management can lead to increased earnings from public funds, the public agency improves its fiscal position, which may enable it to make some public improvements it would otherwise be unable to do.

Short-term investment and financial management activity can take many forms. Among these are:

- Bond anticipation notes, usually issued for projects and paid off by long-term tax-exempt bonds (obviously involving a degree of risk).

- Grant anticipation notes, issued to cover cash flow deficits before grant receipt.

- Revenue anticipation notes, issued to meet short-term cash flow deficits, and secured by future revenue. Usually the proceeds from the sale of these notes are invested at higher rates of return, with public agencies retaining the arbitrage earnings.

- Tax anticipation notes, secured by receipt of specific tax revenues.

- Tax-exempt commercial paper, short-term unsecured promissary notes issued for both capital project financing and to meet short-term cash flow deficits.

- Project demand notes, short-term notes for capital projects that permit investors to get their investments back on short notice, usually seven days.

Implementation Considerations

Local public agencies can explore all forms of short-term financial management to maximize the return on public funds. Financial management involves a comprehensive awareness of risk, but prudent and aggressive money management strategies may reduce long-term capital costs if improvements can be financed sooner through such actions.

Benefit Assessments

Benefit assessment as an option for infrastructure financing highlights a fundamental debate in public finance between the so-called "benefit" principle and the "ability to pay" principle. The benefit approach argues that payment should be in line with the benefit received from public services. The ability to pay approach argues that payment should be in line with one's income or wealth so that equal amounts are paid by taxpayers with equal ability to pay.

Benefit assessment districts have been widely used in California, dating to the early part of this century. It has traditionally been used to pay for certain public improvements such as streets, lighting and drainage facilities. The general principle underlying the use of these districts was clearly stated [Solvang Municipal Improvements District v. Board of Supervisors of the County of Santa Barbara, 1980]: "[The] general public should not be required to pay for special benefits for the few, and the few specially benefitted should not be subsidized by the general public." In that case, the California Court of Appeal specifically warned against the levy of an assessment to pay for the general expenses of a local agency, but sustained earlier opinions that benefit assessment is a valid approach to funding improvements of direct benefit to the affected properties.

Benefit assessments may take the form of some proportional measure such as front footage of land served by the improvements. Assessments are imposed against the benefiting property and become a lien. If the assessment is not paid in full within a specified time, bonds are issued by the local agency for unpaid assessments, and each property owner is required to make payment until the bonds are retired.

Following passage of Proposition 13, the Legislature authorized the use of a form of benefit assessment district to pay for police and fire protection services. Two-thirds approval by local voters was given in Indian Wells, Palm Desert, Rancho Mirage, San Marino and Stanton for such services under this law; elections have failed in several other local jurisdictions, including Los Angeles and Oakland. The courts have yet to uphold the use of this law.

During the 1980-82 session of the Legislature, an exhaustive examination of the various laws on benefit districts was conducted, resulting in certain changes in state law (Chapter 487, Statutes of 1982).

Improvement district bonds issued by California cities as of June 30, 1981 amounted to $76 million, compared to $72 million three years earlier. For counties, the comparable figures were $104 million as of June 30, 1981, compared to $111 million.

Implementation Considerations

Improvement districts may serve as a locally acceptable way to fund capital improvements. Their formation may become a prevalent method to finance new development in the state, usually as an alternative to requiring project developers to construct all necessary infrastructure through development fees and other exactions. While the Task Force believes that such districts and other forms of benefit assessment are a legitimate way to finance capital improvements, it is also concerned that widespread use may reduce public understanding of the local government tax structure and contribute significantly to increased costs borne by purchasers of new housing.

Community Facilities Districts

Under California law, community facilties may be provided and constructed through a wide variety of financing techniques. Because of concerns about the diminished ability of local agencies to finance such facilities after Proposition 13, and because a growing number of local agencies are asking developers to pay for them through development fees, the Legislature in 1982 enacted the Mello-Roos Community Facilities Act of 1982. This act was enacted by Chapter 1439 (SB 2001) and Chapter 1451 (AB 3564). The two must be read together.

As enacted, local agencies may form a community facilities district, under specified proceedings. A special tax may be submitted to the voters for facilities and activities specified in the district. The district takes effect upon a two-thirds vote in favor of levying the special tax. Improvement district bonds may be issued to provide funds for capital facilities.

Facilities and services permitted under the act include:

- Police protection, including criminal justice facilities limited to jails, detention facilities and juvenile halls.
- Fire protection and suppression and provision of ambulance and paramedic facilities and services.
- Purchase, construction, expansion or rehabilitation of property with a useful life of five years or longer, including but not limited to: local park, recreation or parkway facilities; elementary and secondary school sites and structures, libraries, and any other governmental facilities the legislative body creating the district is authorized by law to construct, own, or operate.

A community facilities district may not be used to "supplant" existing facilities or services of the local jurisdiction, and to the extent any capital facility is provided under the act, "a duplicate levy, impact fee, or other exaction may not be required" under Section 66477 of the Government Code for parks and recreational facilities.

Implementation Considerations

Because this involves new state law, formation of community facilities districts is uncharted territory and implementation experience is lacking.

Redevelopment Authorities

Reduced property tax revenues and the growing infeasibility of traditional techniques for financing infrastructure have stimulated interest in and use of redevelopment authority. The Legislature in 1976 redefined "blight" for purposes of redevelopment law. "Blight" is property suffering from economic disuse because of one of the following conditions:

- Faulty planning
- Inadequately or irregularly sized lots
- Lots disregarding land characteristics and nearby conditions.
- Inadequate public improvements, facilities, open space, and utilities that cannot be eliminated without redevelopment
- Depreciated property values, impaired investment and economic maladjustment
- Lands subject to water submersion.

Redevelopment activity is generally financed through tax increments--the growth in property tax revenue from rising property assessments in the redevelopment project area. Although Proposition 13 reduced the property tax rate and capped the rise in assessed value at 2 percent annually for property continuously held, it actually enhanced the importance of construction-related tax increments. New construction in redevelopment project areas expands the tax increment revenues.

Tax increment financing is obtained by freezing the assessed value of property in the project area at the time the redevelopment plan is adopted. Any property tax revenue produced by an increase in value over the frozen base may be used by the redevelopment agency to repay indebtedness it incurs in redeveloping the area. The exception is that 20 percent of such revenue must be used to increase and improve low- and moderate-income housing in the project area, as provided in Section 33334.2 of the Health and Safety Code. When all project area indebtedness is repaid, the assessed value base is unfrozen, and the tax increment is paid to all local taxing entities. Until that time, however, tax revenues above the level received in the base year go to the redevelopment agency.

City use of a redevelopment authority, therefore, reduces the property tax revenues available to other local government agencies (counties and special districts, including school districts). It may also increase the costs to the state, since additional school financing must come from this source.

A number of proposals were considered by the Legislature in the 1980-82 session to change redevelopment law to deal with problems that have arisen through greater use of redevelopment agencies. None of the major bills passed, however.

Implementation Considerations

The Task Force recognizes that the redevelopment authority is an available option for improvements in the existing public infrastructure. It is concerned that this use by counties and cities will constrain and may prevent the efficient delivery of public services by other local agencies. While it believes legislation will be necessary to correct certain adverse consequences of applications of existing redevelopment law, the Task Force--in keeping with its decision to restrict this report to existing available options--does not recommend specific legislative changes at this time.

Independent Authorities

California law permits local agencies to enter into agreements under the Joint Exercise of Powers Act to exercise any power common to the parties to the agreement. This law would permit local agencies to join together to provide for the provision of local infrastructure and public services, thereby reducing overall costs.

An example of the use of this law to provide public services is the decision by the Cities of San Carlos and Belmont to merge their separate fire departments into the South County Fire Protection Authority. Although the consolidation efforts began prior to Proposition 13, the reduced property tax revenues caused each city to eliminate a fire station. The reorganization enabled the new authority to increase its prevention efforts and increase the level of service available.

Special Taxes

Article XIII A of the State Constitution permits local agencies to impose "special taxes," except for property taxes and new transactions or sales taxes on property sales, by a two-thirds vote. Prior to a recent State Supreme Court ruling, measures for the following types of services had been approved by votes in several local governments:

- Municipal services (Atherton, Hillsborough and Piedmont)
- Flood control (Lakeport and Palos Verdes Estates)
- Mosquito abatement (Alameda County)
- Paramedics (El Cajon, Palos Verdes Estates and San Rafael)
- Fire services (Palos Verdes Estates)
- Police services (Palos Verdes Estates)
- Streets (Palos Verdes Estates)
- Sidewalks (Palos Verdes Estates)
- Road maintenance (Overlook Road Maintenance District, Santa Clara County)

In a recent case, the State Supreme Court ruled [City and County of San Francisco v. John C. Farrell, 1982] that a payroll and gross receipts tax levied on city business, with the proceeds placed in the city's general fund, were not a special tax. The court concluded that special taxes are "taxes levied for a specific purpose rather than...a levy placed in the general fund to be levied for general governmental purposes." The ruling might make it easier for local governments to levy additional taxes as long as the proceeds of these taxes are placed in the general fund for general purpose expenditures.

Motor Vehicle Fuel Taxes

In 1981, the State Legislature enacted legislation providing more funds for transportation improvements at the state and local level. Included in the legislation (SB 215, Chapter 541, Statutes of 1981) was a provision permitting local officials to propose to their electorates to adopt a motor vehicle fuel tax.

Under provisions of the law, a county may enact the tax, in 1-cent increments, per gallon on motor vehicle fuel. The ballot proposition must, however, first be approved by the board of supervisors and a majority of the city councils of the cities having a majority of the population of the incorporated areas of the county. In addition, the county and a majority of cities having a majority of the population of the incorporated area of the county must have a written agreement with respect to the allocation of the revenues between the county and the cities.

Although several counties attempted to win voter approval of an increase in local fuel taxes (none in the Bay Area), none was approved.

Revenue Bonds

While Proposition 13 limited the use of general obligation bonds, revenue bonds are still available as a funding source under the Revenue Bond Act of 1941. Revenue bonds are those in which the principal and interest are payable from the revenues of a revenue-producing enterprise. Specific infrastructure improvements explicitly authorized under revenue bond authority include water treatment, sanitation, fire protection, recreation, garbage collection, sewer treatment, public parking, hospitals, light, heat and power generation. In addition the Act authorizes revenue bonds for any enterprise activity including transit, seaports, harbors. They are generally issued after majority vote of the voters to finance a public improvement, used to deliver a service for which the public agency levies a fee or user charge. A charter city can market such bonds without approval of the voters of the charter permits.

Between 1977-78 and 1980-81, indebtedness under revenue bonds issued by California cities rose from just under $3 billion to $3.8 billion. This contrasts to a decline in general obligation bonded indebtedness from $1.1 billion to $900 million in the same period. For counties, revenue bond indebtedness rose from $6.4 million in 1977-78 to $15.3 million in 1980-81. General obligation bond indebtedness declined from $96 million to $60 million during the same period.

A special type of revenue bond is the lease-revenue bond. These can be issued by a non-profit corporation or special authority to construct a facility to be leased to a local government. Lease payment provides the revenue to pay off the bond; when the bond is retired, the facility is turned over to the local agency. Lease payments are typically a direct obligation of the lessee's general fund. Lease revenue bonds do not have to be approved by the electorate but do require approval by ordinance of the lessee. This type of bond can be used in conjunction with various sale and leaseback arrangements.

Implementation Considerations

It is likely that revenue bonds will continue in importance as a source of funds for public facilities operated as enterprise activities. The Task Force recommends that each public agency evaluate its level of user charges. Since these are the repayment method for revenue bonds, it is important that public agencies continually ensure that user charge revenues are sufficient to repay bonds.

Lease-Purchase Financing

An effective way to involve the private sector in capital facilities improvements is through the use of traditional lease and lease-purchase arrangements. While there has been much discussion recently about innovative sale-leaseback transaction that take advantage of opportunities under the 1981 Economic Recovery Tax Act, lease and lease-purchase arrangement that have been traditionally available to local governments should be considered as well. While equipment purchase has been the major lease-purchase use by California local governments, this technique has also been used to acquire real property, construct buildings and other facilities. A typical approach has been the establishment of a nonprofit corporation at the request of a local agency to build a structure leased to the local agency. The corporation issues bonds secured by a long term lease with the local agency. The lease payments are set sufficient to retire the debt and upon retirement, title to the facility passes to the local agency. This type of bond is known as a lease-revenue bond. Lease revenue bonds do not have to be approved by the electorate but do require approval by ordinance of the lessee. The State Controller in the annual report of transactions of cities and counties for 1980-81 estimated the dollar value of such leases at slightly more than $2 billion divided equally among these cities in aggregate and counties in aggregate.

From the standpoint of tax treatment, there are basic distinctions between operating and lease-purchase agreements:

An operating lease is usually structured to meet the IRS guidelines of a true lease. The lessee, a city for example, is not buying the asset; it is simply using it for a period of time. The term of the lease is usually less than the asset's useful life, and the parties may not agree on a purchase price to transfer ownership at the end of the lease term. The lessee can only buy the asset at the ends of the lease for its fair market value. The lessor is usually responsible for maintenance, insurance and taxes. If the operating lease meets the true lease guidelines, the taxpayer/lessor may claim depreciation benefits and tax credits on new equipment and on qualified rehabilitation expenditures. Qualified expenditures occur on 30-year-old commercial or industrial buildings and historic structures if the lessor and lessee are private, for-profit businesses. If a city is the lessee, the lessor may claim depreciation benefits and not the tax credit, with one exception. The taxpayer may claim the rehabilitation investment tax credit on qualified expenditures even if the city is the lessee of the building.

A lease-purchase agreement is not a true lease and therefore the IRS will not allow favorable tax treatment, stating that the transaction is a sale. In effect, the lessor is selling the asset to the lessee, and the sale is financed by the lease payments. If a city is the lessee, the interest portion of the lease payment may be tax-exempt to the lessor, if it meets the obligation requirements of the Internal Revenue Code while avoiding being classified as debt or city law. To avoid classification as debt, the lease-purchase agreement usually has a "funding out" clause that allows the local government to terminate the lease. Lessors may charge a higher interest rate because the agreement may be terminated. Such arrangements frequently include a non-substitution clause, preventing the jurisdiction from turning to another vendor to lease the same asset for a period of time.

Implementation Considerations

Cities and counties can review the advantages of financing capital facilities improvements utilizing traditional lease-purchase arrangements. Compared to more complicated sale-leaseback arrangements discussed in the following section, they are relatively straightforward to set up and noncontroversial.

Certificates of Participation Lease Financing

Because of the large dollar amounts needed to finance certain public facilities through lease purchase arrangements, numerous investors may be needed to participate. The requirement to have numerous investors has resulted in the development of what has come to be called a certificate of participation. This is simply a piece of paper, similar to a bond, serving as evidence that the investor owns an undivided percentage interest in the lease payments of the local government agency, which leases the new facility. These certificates are generally issued in $5,000 denominations. They are not issued by the public agency, and therefore do not constitute evidence of indebtedness. Thus these certificates do not have to be put to a vote under Article XIIIB of the Constitution.

The City of Hayward has used such certificates to finance a 10-year schedule of capital improvements ranging from computer software to fire service equipment. The City of Santa Rosa financed a $4 million police station in its public safety complex.

Creative Use of Bond Instruments

The uncertainty in bond markets because of the national economic picture has led to more innovative ways to structure bond issuances. Among the most widely publicized have been zero coupon bonds. These sell at a large discount from their face value and pay no interest. The investor's return is the difference between the issue price and the

redemption value. For corporate bonds, investors are required to amortize the return, paying a tax on the annual earnings (equivalent to interest) even though such earnings are not received until the bond matures. For municipal bonds sold in this way, the investor is not required to pay Federal income taxes, and earnings may also be exempt from state and local taxes.

Other creative bond instruments could be structured by local agencies. These could involve jumbo coupon bonds (sold at par value with a single coupon indicating interest at maturity), stepped coupon bonds (with specific, identified interest rate changes), variable rate bonds, compound interest bonds (with the return to the investor at maturity the principal plus interest compounded at a specified rate), stripped coupon bonds (bonds sold without coupons, which are then sold separately), and tender option bonds (with investors having the right to redeem before maturity).

Implementation Considerations

Since the Task Force believes that bonds will remain a major financing tool for local governments, it is important to improve their issuance to compete in investment markets, particularly when the economy remains sluggish. Therefore local agencies can consider issuance of more innovative bond instruments, and work with a qualified financial advisor or underwriter, as well as bond counsel.

Charitable Contributions

Public agencies can receive from individuals or corporations gifts that are tax deductible to the contributor.

After Proposition 13, many local agencies embarked on campaigns to solicit charitable contributions. Among the most innovative in the Bay Area was the city of Menlo Park, which published a Community Gifts Catalog. For specific donations of funds, the city could purchase playground equipment, street and park trees, craft supplies, police and fire equipment, library books and park benches. The city manager estimated that more than $10,000 in gifts were made to the city.

Private Enterprise Licensing

The private sector has traditionally been used to provide certain public services under contracts and other arrangements. Contracts to private firms for collection and disposal of solid waste is common. So are "franchises" issued to private firms for the privilege of using city facilities. Types of firms frequently required by ordinance to pay such "franchise" fees include public utilities, taxicab and ambulance firms, and cable television companies.

The use of licensing, franchises and other forms of "privitization" of public services can produce revenues for local jurisdictions; others can reduce local government costs. While these are traditional techniques, local franchises produce only about 1 percent of municipal revenues. Recent U.S. Supreme Court decisions may reduce their viability.

Although local franchises and other forms of exclusive contracts restrain free trade, the Sherman Anti-Trust Act does not clearly prohibit them. The Supreme Court's decisions exempt a local government's restraint on competition from the Sherman Act if it meets a two-part test:

- If the local action occurs pursuant to a "clear articulation and clear expression of anti-competitive policy by the state."
- If local implementation of this policy has "active state supervision."

In January 1982 the U.S. Supreme Court applied these tests to a city's cable television franchise, and found it did not meet the first standard [Community Communications Company, Inc. v. City of Boulder]. The implications of the decision are far-reaching, and may cause innumerable problems for local government franchise agreements as well as other local government actions, which may be challenged under the Boulder decision alleging they constrain the free exercise of trade. The most important questions for local agencies include whether charter cities can under the California Constitution enact anti-competitive ordinances and satisfy both tests, and what form "active state supervision" will be for actions of general law local governments.

Implementation Considerations

Although Congress may enact legislation that would alter the interpretation of the Boulder decision, thus limiting challenges of local government actions under the Sherman Act, the Task Force believes it important that local agencies, using the two-part test in that decision, review their existing franchise agreements. In addition, it may be possible to use the Boulder decision to local advantage. If local governments are subject to scrutiny for acting to restrain competition, it may be important or necessary to promote competing services.

Public Agency as Entrepreneur

A recent study prepared for the California Tax Foundation indicates that local agencies and private developers are increasingly bargaining over infrastructure financing. While most local jurisdictions now require some form of dedication or exaction under the Subdivision Map Act, a wide variety of other agreements have been negotiated. These vary from payments in lieu of taxes, construction of public facilities, and joint public-private use of shared facilities to private development of public

While Federal tax law changes in 1981 provided an important way to finance mass transit rolling stock, leveraged lease arrangements are also possible in other ways. The best publicized Bay Area example has been the case of the Oakland Museum.

The City of Oakland decided to sell the museum and the city auditorium, retaining title to the land and leasing it to a private sector partnership purchasing the museum. Funds from the sale of the museum will be used to pay the principal and interest on improvement bonds (see benefit assessment discussion below) issued to refurbish the auditorium, which can then be sold. The city will be able to repurchase the facilities when the leases expire. Oakland City Manager Henry Gardner, in a report to the Council, said, "The best part of all is that under conservative assumptions, no general funds will be required to undertake this major renovation."

It is important to distinguish between two types of sale-leaseback approaches:

- safe harbor lease
- tax exempt leveraged lease.

Under a safe harbor lease, two private parties may enter into a sale and leaseback arrangement, which is not a lease at all, but receives the tax treatment of a lease. This is a way for a company with an unprofitable year to sell its unused depreciation and tax credit benefits to a profitable company to reduce tax liability. The 1981 tax law allowed the safe harbor lease to be used for one specific public purpose--to finance mass transit vehicles. Depreciation benefits can be transferred, but no investment tax credit is available. The 1982 tax act altered the safe harbor provisions, greatly restricting its use, except for mass transit vehicles.

In some cases, tax-exempt financing can be combined with some of the sale and leaseback arrangements. The combination of tax benefits accruing to private firms and/or individuals along with the lower cost of tax-exempt financing, such as in the case of industrial revenue bonds, results in a lower overall cost to the local jurisdiction.

Similarly, it is appropriate to use a leveraged lease structure for certain asset investments. The leveraged lease involves three parties:

- The owner and lessor who under a true lease arrangement provides between 20 and 30 percent of the asset's costs in the form of equity.
- The lessee.
- The lender.

property. In such cases, the local agency assumed the role of an entrepreneur.

Examples include:

- Sale of locally generated power to Pacific Gas and Electric Co. (Fairfield).
- Direct competition with Pacific Gas and Electric for the power generation rights for certain hydroelectric projects (Northern California Power Agency and others).
- Obtaining, through bargaining, a percentage of profits from developments such as shopping centers (Fairfield).
- Operation of municipal insurance programs using private sector administration (Mill Valley).
- Selling surplus property to obtain funds for maintenance purposes (Santa Clara Unified School District).
- Property exchanges and private development of new facilities (Foster City and San Mateo City Elementary School District).
- Sale of air rights (used for housing development in the Mission District in San Francisco and in San Diego).

Implementation Considerations

The Task Force believes that entrepreneurial behavior by local agencies is to be encouraged. However, the Task Force also believes that such activity should be undertaken with a well-defined public purpose. Where the private sector does more efficiently or effectively provide such services, local governments can encourage private sector service delivery.

Sale-Leaseback Approaches

Beyond traditional lease and lease-purchase arrangements, there are a range of more complex public-private transactions that may be considered by local governments.

The 1981 Economic Recovery Tax Act made sale and leaseback arrangements more attractive to the private sector by accelerating cost recovery through depreciation. What makes such arrangements especially attractive is the ability of private firms to claim tax benefits from property where public agencies may not.

In a leveraged lease transaction private investors are generally willing to pay for the tax benefits that may be derived from ownership of the public property. In most of these transactions, the governmental entity will benefit by an amount equal to the net present value of the tax benefits transferred to the private entity.

In most instances, the governmental entity would like to finance the acquisition of the property by issuing tax exempt bonds. The rules of leveraged leasing become complicated by the limitation on the use of tax exempt securities for private purposes. If the investors are to receive the tax benefits that they bargained for, title to the property is transferred to the private entity and the lease from the private entity to the public entity must be deemed a true lease. It is difficult to make such a transfer when there is no assurance that the governmental entity will eventually regain title to the property.

Table 2 compares the tax treatment for different types of transaction--both traditional lease-purchase and more complex sale leaseback approaches. The models described in the inset illustrate two types of sale-leaseback approaches.

Implementation Considerations

Many local jurisdictions may lack the capacity to undertake complicated sale-leaseback arrangements such as that used in Oakland. While general law cities can engage in sale-leaseback, their ability to issue tax exempt bonds for lease leveraging is restricted. Furthermore, the financial and legal arrangements necessary to execute a complex sale-lease approach must be considered before undertaking such an activity. On the other hand the fiscal attractiveness of such alternatives should be considered by both local government and private sector leaders.

TABLE 2

Comparison of Tax Treatment of Different Types of Transactions

		Ownership City/Private	Tax-exempt Rate	Accelerated Depreciation	Investment Tax Credit
1.	City borrows/invests (equipment or buildings).	X	X		
2.a.	City uses operating (true) lease for equipment or buildings other than qualified renovated buildings.	X	Optional	X	
b.	City uses operating (true) lease for qualified renovated buildings.	X	Optional	X	X
3.	City uses lease/ purchase (equipment or buildings).	X			
4.	City uses sale/ leaseback under safe harbor lease (mass commuter vehicles only).	X (reverts to City at end of lease)	X	X	
5.a.	City uses sale/ leaseback under true lease for equipment or buildings other than qualified renovated buildings.	X	Optional	X	
b.	City uses sale/ leaseback under true lease for rehabilitated buildings.	X	Optional	X	X
6.	City uses service contract (equipment or facilities).	X	Optional	X	X

Note: In Numbers 2 through 5 the City would be the lessee.

SALE AND LEASEBACK MODELS

Following are several conceptual models, reflecting some of the alternatives discussed previously under the sale and leaseback option, for a city to consider in financing and managing assets. Note that state and local laws, amendments to Federal law and regulations, and financial and nonfinancial factors must be explored in detail before proceeding with project financing under one of these models. In other words, local agencies should proceed with caution, ensuring first that any alternative project financing meets local, state and Federal legal requirements, and second that it is financially and politically feasible. The purpose of presenting these models is to stimulate ideas that can be explored in greater depth by local agencies.

(1) City Buildings and Facilities in Need of Improvement--The 1981 Economic Recovery Tax Act included one exception to the general rule that property leased to a municipality cannot qualify for the investment tax credit: rehabilitation expenditures on qualified structures, those at least 30 years old.

Therefore, a local agency could sell a facility to a private concern and lease it back with the provision that the private owner rehabilitate it. In certain cases the proceeds to the local government could be invested to help cover the lease payments and subsequent repurchase of the asset. The private owner would reflect in the lease payments the savings from depreciation (15-year straight line) and the tax credit.

A more attractive alternative to a local government, and to investors in a limited partnership, might be for the local agency to do the rehabilitation and then sell the facility and lease it back from the partnership. Such work might be financed through the use of revenue bonds secured by the sale of another existing, appreciated asset. Although the partnership would forego the investment credit, the depreciation benefits and deductibility of the mortgage interest payments may be sufficiently attractive to the partnership in meeting its required rate of return and to the local agency by providing a less costly way of financing needed improvements.

This alternative may also avoid the potential legal problem of public improvements requiring competitive bidding. Before a local government enters into a sales contract, it will have already received competitive bids to do the rehabilitation and decided on who will perform the work at what fixed cost. Therefore it knows its costs before signing a sales agreement, and rehabilitation will be accomplished through a competitive process.

As explained in the next example, these arrangements could be combined with tax-exempt industrial revenue bonds (IRB) to finance the purchase from the city or with tax-exempt municipal revenue bonds to finance the rehabilitation. In many cases tax-exempt financing will be required to make a project attractive to private investors. The City of Oakland recently used both.

(2) Tax-Exempt, Leveraged-lease Financing of New or Existing Facilities or Equipment--This arrangement allows a city to build or renovate a facility, sell it to a limited partnership and then lease it back at a cheaper cost than if the city financed it by traditional methods. It combines the benefits of tax-exempt financing and depreciation and mortgage interest deductions in such a way that the lessor, the limited partnership, can pass them on to the city. The city receives cash from the asset sale, a portion, perhaps 80 percent, of which it can invest in a fund to cover (future lease payments) and the repurchase of the asset. The remaining 20 percent the city can use now for other improvements.

The city might also finance the renovation or construction of the asset prior to the sale with the proceeds of a tax-exempt municipal revenue bond, secured by the sale of an existing asset. The city could then lease back the asset. This approach allows the city to leverage equity build-up in its asset to provide funds to complete other needed improvements.

A similar approach may be used for equipment where tax-exempt financing and depreciation benefits combine to lower the cost to the city. The major difference is that the recovery period for equipment is usually 5 years, much shorter than the 15 years for real estate. Therefore, the cost savings are greater to the city since the limited partnership takes the depreciation benefits over a shorter period. No investment tax credit is available, however.

Following is a summary of the major characteristics of tax-exempt, leveraged-lease financing:

- It applies to new and existing facilities. Examples include office and school buildings, court houses, warehouses, solid waste disposal facilities and major equipment such as cogeneration.

- It reduces the municipality's cost by 1-1/2 to 2 percentage points below the conventional bond financing cost. Goldman Sachs suggests that the savings can be 4 percentage points on major equipment projects, such as cogeneration, because of the shorter five-year recovery period on equipment.

- Within certain restrictions, the sale proceeds may be available for any use, including a capital fund. This type of transaction usually provides 20 percent of the sale proceeds for other uses--money the city normally would not have had under a traditional city bond financing. In other words, the city usually has to set aside 80 percent in a capital fund to ensure future lease payments and repurchase of the asset.

- The city does give up its ownership rights, which creates two inherent risks. The first is the residual value of the building which may be high at the time of repurchase or during the "shirt-tail" or final period of the lease for which lease payments can be prearranged. The second risk is the capital fund reinvestment rate assumption. The first risk is minimized because the city encumbers the lease and hence its economic value by retaining ownership of the ground and leasing it to the limited partnership. In addition, the city invests a portion, perhaps 80 percent of the sale proceeds, in a capital fund. The return will cover lease payments and repurchase of the asset if desired. The second risk is minimized by using a conservative reinvestment rate which still provides the income required to cover the lease payments and repurchase.

- The city must have the authority to sell assets and authorize a ground lease, and it must structure the project to avoid having the lessor charged with real estate taxes.

7. Analyzing Alternative Methods

In considering various funding possibilities it is important to have an organized method for evaluating their appropriateness and feasibility. The Task Force decided at one of its first meetings on a set of criteria to evaluate the key features of each option.

Certain criteria are similar to traditional economic criteria; others involve concepts of public administration. The evaluation criteria used are defined and explained below.

Applicability

How may the option be used to fund public facilities? There are three separate issues: What type of infrastructure does the option address, summarized as "Need Class"? Can the option be used for new facilities and/or maintenance of existing facilities? Which types of local government agencies may use the option?

Key Procedures

This is a descriptive criterion summarizing the basic features of how the option is established and used.

Adequacy of Funding

This criterion is similar to the economic concept of "sufficiency of yield." In other words, does the option produce enough money to meet the need identified by the local decision-maker?

Equity

This criterion addresses two questions. Are there differing abilities of certain segments of the community to pay for the revenue option? By using the option, do the benefits received differ among these segments?

Economic Effects

Public and private sectors may be affected in different ways by the use of the revenue option. These effects should be considered by the decision-maker.

Ease of Public Administration

Since the options listed are to be implemented primarily by local governments--sometimes in cooperation with the private sector and sometimes without substantial involvement--it is important for the decision-maker to assess the feasibility of the option in terms of the unique circumstances in which it is to be implemented. Certain arrangements may be more easily implemented in particular types of jurisdictions. Others may have certain "start-up costs," such as acquiring particular information relevent to the jurisdiction and its needs, before a decision can be made on the use of a particular option.

Legal Constraints and Opportunities

This criterion is used to identify key issues that may affect the ability of a local agency to implement the option. Use of a particular idea, for example, by certain types of jurisdictions may not be authorized by State law or might require amendments to existing charters of charter cities and counties.

Each of the options may be evaluated by local decision-makers using the above criteria. Some options might be judged infeasible for a particular application based on the importance of a particular criterion. For example, in one case sufficiency of yield may be the most critical factor, while in others the potential equity problems or difficulties in administration may prove more important. In the fiscal analysis, judgements of feasibility will derive primarily from the views of the public and private decision-makers most affected.

In the following pages these evaluation criteria are used to analyze the options discussed in Section 6.

Evaluation Matrix for Financing Techniques

Financing technique	Applicability	Key procedures	Adequacy of funding
Development Fees	*Need Class* Applicable to wide variety of improvements: Streets, accessways, easements, drainage systems, bicycle paths, local transit facilities, sunlight easements, park and recreation facilities, schools, collector sewers, bridges, groundwater recharge facilities. *New Facilities or Maintenance of Existing Facilities?* Generally new facilities only. Interest earned on park dedication in-lieu fees paid by developers may be used for park maintenance. *Governmental Unit type* Cities, counties and special districts, including school districts.	Governing body or administrator establishes fee; development fees generally must be adopted by governing body after public hearing.	Whether funds sufficiently pay for actual costs of facilities depends on care in estimating those costs, and establishing fees accordingly.
User Charges	*Need Class* Applicable to all enterprise activities. *New Facilities or Maintenance of Existing Facilities?* Both. *Governmental Unit Type* Cities, counties and special districts for enterprise activities.	Governing body establishes fee, usually by ordinance, minute order or other form of policy action.	Not always sufficient to pay for replacement costs of existing facilities, especially sewage treatment.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay Generally do not take into account ability to pay and therefore are potentially inequitable. *Benefits Received* Fee is directly related to costs of providing the service but may not include all costs.	*Private* Increases private cost of development, however, this cost is usually borne by purchasers of improved property. *Public* Use of fees charged requires public sector to account for actual costs of providing the service.	Most fees are set simply to make administration easy.	Development fees cannot exceed "reasonable cost of providing service."
Ability to Pay Generally do not take into account ability to pay and therefore are potentially inequitable. *Benefits Received* Fee is directly related to costs of providing the service but may not include all costs.	*Private* Some user fees are set using so-called "lifeline" concept; large users of service may subsidize residential consumption (e.g., water). *Public* Use of user charges encourages public sector to account for actual costs of providing the service.	Most user charges are set simply to make administration easy (e.g., water charges on a per gallon basis).	Very few impediments to extracting all costs of providing service.

Financing technique	Applicability	Key procedures	Adequacy of funding
Short-Term Money Management a. Bond anticipation notes b. Grant anticipation notes c. Revenue anticipation notes d. Tax anticipation notes e. Tax-Exempt Commercial Paper f. Demand Notes	Demand note usually used for large capital facility construction period. Other devices may simply improve local agency cash-flow situation.	*Anticipation Notes* Agencies sell notes and repay when revenues are received; agencies often invest funds and earn interest higher than that paid out to investors. *Tax-Exempt Commercial Paper* Short-term note backed by line of credit. *Demand Notes* Short-term note payable after specified notice period; usually backed by line of credit.	Modestly increases local revenues assuming invested funds can earn more than interest paid to investors.
Benefit Assessment	*Need Class* • *Most Applicable* Curbs and Gutters Streets Sidewalks Storm Sewers/Drainage Street Lights Water and Sewage Services • *Probably Applicable** Acquisition of Transit Vehicles Acquistion of Police and Fire Vehicles Construction of Police and Fire Stations • *Potentially Applicable* Operation of Transit Districts Police and Fire Protection Services *Authorized by statute; not upheld by courts. *New Facilities or Maintenance of Existing Facilities?* Operation and maintenance of drainage, flood control and street lights is authorized by statute. Governmental Unit type All local governments; appears most used currently by cities and special districts.	Depending on specific enabling legislation, public hearings, elections and ⅔ majority vote may be required.	Sufficient if costs of improvements are carefully calculated in advance and assessment levels are set to recapture costs.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay No effect. *Benefits Received* May provide tax subsidy.	*Private* May draw funds from private sector investment because of tax exempt status of income received. *Public* Would accommodate more of demand for tax-exempt investments. Public agencies may invest funds received from tax exempt anticipation notes. The earnings less interest paid is the value of the arbitrage.	*Tax Exempt Commercial Paper* Issues should have at least $25 million in short-term debt per issue. *Demand Notes* Optimal size $15-100 million. *Tax Anticipation Notes* Usually used when revenues fall into predictable patterns.	Line of credit must not be used for other purposes. Federal arbitrage regulations may limit the dollar amounts of certain short-term securities that can be issued, and also limit length of time to maturity. Additionally, State regulations may limit the dollar amount to 85% of the expected tax receipts.
Ability to Pay Assessments do not take into account ability to pay and therefore are potentially inequitable. *Benefits Received* Per unit benefit should be the same for all parcels of similar classes of property within district.	*Private* Households and firms within geographic area of assessment district must perceive benefits to be derived from levying the assessment; so long as costs of providing the benefit are carefully calculated and the assessment level set to capture the costs, adverse economic effects should be minimized. *Public* No adverse effect on revenues of other governmental levels, since assessments paid are not deductible in most cases from Federal and State income taxes. Preliminary public costs may not be recovered if voters turn down district formation.	If assessments are calculated simply for administrative convenience, the greater the potential to raise too little or too much money compared to the cost of providing the benefit.	Current State law in some cases has not been tested in the courts. Benefit assessment districts would be potentially more valuable if, in addition to calculating benefits received to property, tax deductions or credits were allowed to minimize equity problems

Financing technique	Applicability	Key procedures	Adequacy of funding
Community Facilities Districts	Permitted under provisions of the 1982 legislation are facilities and services such as: • Police protection, including jails, detention facilities and juvenile halls. • Fire protection and suppression and provision of ambulance and paramedic facilities. • Property with useful life of five or more years.	Local agencies may form district, and levy special tax for its activities, which requires two-thirds approval.	Should be sufficient if costs of district are carefully calculated prior to election.
Redevelopment Authorities	*Need Class* Applicable to a wide variety of improvements in project area. *New Facilities or Maintenance of Existing Facilities?* Can be used to rehabilitate or provide new construction within the project area. *Governmental Unit Type* Available to cities and counties (for unincorporated area).	Local agency may form redevelopment agency. Then, using tax increment financing, any revenue generated by growth in assessed value over a base year is revenue for repayment of any costs incurred by the redevelopment agency to develop the project area to eradicate blight conditions.	Sufficient.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay Potentially inequitable since special tax would not be calculated on this basis. *Benefits Received* Per unit benefits should be the same for all parcels of similar classes of property.	*Private* Households and firms within geographic area of district must perceive benefits to be derived from special tax levies; so long as costs of providing the benefit are carefully calculated and the levy set capture the costs, adverse economic effects should be minimized. *Public* Preliminary public costs may not be recovered if voters turn down district formation.	Relatively straightforward but new procedure that can be attractive in developing areas. Does require voter approval.	New law has not been tested in courts.
Ability to Pay Inequities may arise between redevelopment areas and taxpayers that benefit from tax increment financing and those of the jurisdiction outside the redevelopment area. *Benefits Received* Tax increment financing derives revenue from the increased property values arising from expanded economic activity in the area. Equity is achieved based on the benefit principle.	*Private* Redevelopment authority can act as an economic stimulus in blighted areas by helping to ensure expanded employment, economic activity and stable tax bases. Its power to generate revenue for capital improvement can help aid in the economic stimulus process. *Public* Diverts property tax revenue growth from other local public agencies to the redevelopment agency for the life of the project.	The redevelopment process is established in State authorizing law and the procedures are straightforward. Issues arise concerning accountability of a city's independent authorities to other general purpose local governments in project areas. Proliferation of special agencies can create problems of coordination in local jurisdictions.	Obligations of the redevelopment agency are not a debt of the community or general taxpayer, but are limited obligations payable solely from the increment allocated to the redevelopment agency from the property in the redevelopment area. Such obligations do not require a vote of the general public.

Financing technique	Applicability	Key procedures	Adequacy of funding
Independent Authorities	Available to all local agencies for all local services and facilities.	Under Joint Exercise of Powers Act, public agencies may agree jointly to exercise powers common to parties to agreement.	Adequate.
Special Taxes	May be used to fund any special purpose activity approved by voters.	Requires two-thirds approval of voters.	Potentially adequate.
Motor Vehicle Fuel Tax	Counties and cities may levy jointly for local streets, roads and fixed guideway purposes.	Requires agreement on by cities and county on amount to be levied, and allocation of revenues, as well as majority vote approval of county voters.	Potentially adequate.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay Not directly relevant. *Benefits Received* Parties must receive benefits or will not agree to provide facilities or services jointly.	*Private* No effect. *Public* May reduce individual jurisdiction's costs of a needed public facility or service if economies of scale can be obtained.	Joint powers agreements are straightforward and simple to execute.	Limitations on exercise of powers to be performed must be same as one of parties to agreement, which party must be named.
Ability to Pay Potentially inequitable unless taken into account in designing tax to be levied. *Benefits Received* Not directly relevant.	*Private* May cause relocation of existing commercial or industrial firms. *Public* Improved fiscal stability of local agency.	Easy to administer once voter approval obtained.	May not be calculated as property tax or sale or transaction tax on property transfer.
Ability to Pay Inequitable because does not reflect ability to pay. *Benefits Received* Equitable because tax is set on a user charge basis.	*Private* Might affect business location decisions. *Public* May improve capital budgeting programs.	Administratively complex to establish ballot measure and allocation of revenues agreements.	Majority approvals specific in law not tested by courts.

Financing technique	Applicability	Key procedures	Adequacy of funding
Revenue Bonds	*Need Class* Water treatment; sanitation; sewage treatment; hospitals; streetlights; and power generation. *New Facilities or Maintenance of Existing Facilities?* New and existing facilities that can generate revenue. *Governmental Unit Type* Cities, counties and special districts authorized to perform enterprise operations.	Authorized under Revenue Bond Law of 1941 or city charter. Requires ordinance or resolution, and underwriting. May require approval by voters.	Level of bonds sold set to recover capital costs, so should be sufficient assuming final project costs stay within budget.
Lease-Purchase Financing	Potentially available for wide variety of equipment or facilities.	Usually involves a set term to acquire property over time.	Sufficient, since lease payments are set to acquire asset over length of lease period.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay No effect since capital must be available to those purchasing bonds. *Benefits Received* Direct Federal tax exemption for interest earned can become a tax subsidy for those of moderate and above incomes.	*Private* May draw funds from private sector investment because of tax exempt status of income received. *Public* Public borrowing must compete with private borrowing in limited bond market. When interest rates are high, bonds may be unsold due to State interest rate limitations.	Requires underwriting and issuance procedures; these are generally routine operations.	While use of general obligation bonds has been severely limited in California because of Proposition 13, revenue bonds remain available. They are not backed by the full faith and credit of the jurisdiction issuing the bonds, and this greater risk is reflected in a higher rate that must be offered to attract bond buyers. After January 1, 1984, local agencies are permitted to pay only 10% interest on all forms of indebtedness. May require specific charter amendments where charter restricts issuances to those approved by voters.
Ability to Pay No effect. *Benefit Received* Equitable.	*Private* Interest portion of a lease purchase agreement may be tax-exempt. *Public* Improved ability of public agency to acquire property without tying up local funds for single payment financing.	Simple to establish through lease-purchase agreements.	Few constraints on public agency.

Financing technique	Applicability	Key procedures	Adequacy of funding
Certificates-of-Participation Lease Financing	Potentially available for any facilities or equipment that would be leased or lease-purchased.	Certificates are issued in registered form serving as evidence to investor that he owns an undivided percentage interest in the lease payments of the jurisdiction. Escrow agent sells certificates to underwriter, which sells to investors.	Adequate.
Creative Use of Bond Instruments	Potentially available if authority to sell bonds exists.	*Zero Coupon Bonds* Bonds are purchased at substantial discounts, and purchasers receive face value at maturity. *Variable Rate Bonds* Interest paid varies according to specified formula.	Potentially sufficient. Sufficient.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay No effect. *Benefits Received* Not directly relevant.	*Private* May draw funds from private sector investment because of tax exempt status of income received. *Public* Interest rates and issue costs are comparable to bond issues.	Does not require time and effort needed for lease revenue bond issues. Certificates usually issued in $5,000 denominations.	Since certificates not issued by local agency, they are not evidence of indebtedness of agency. Since the lease is not long-term debt, no voter approval is required under Article XIIIA of State Constitution.
Ability to Pay No effect. *Benefits Received* Direct Federal tax exemption for interest earned can become a tax subsidy for those of moderate and above incomes.	*Private* Zero coupon bonds issued by public agencies more attractive investments because of tax-exempt status. *Public* Improves marketability of bonds but also increases financial exposure to bond issuers.	Relatively simple but unusual procedure.	Bond counsel review would indicate any potential problems. Congress may act to limit use of zero coupon bonds.

Financing technique	Applicability	Key procedures	Adequacy of funding
Charitable Contributions	Potentially available for many uses; may be used most effectively to maintain *specific* public properties.	Establish a public contributions program for either general contributions (all are comingled) or for specific items (e.g., adopt a pothole or park bench).	Potentially adequate but not likely.
Private Enterprise Licensing	*Need Class* Bridges; solid waste transfer facilities. *New Facilities or Maintenance of Existing Facilities?* New facilities; maintenance costs borne by licensed private firm. *Governmental Unit Type* Cities, counties and special districts.	State law allows granting of licenses and franchises for enterprise operations and public utilities (Section 39732 of the Government Code and Section 6001 of the Public Utilities Code). Granting of licenses and franchises subject to general law or specific charter provisions.	Sufficient if private firm willing to take risks of public enterprise activity.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay No effect. *Benefits Received* Not directly relevant.	*Private/Private* May reduce charitable donations to other services/agencies (e.g., United Way). Funds contributed are drawn from both savings and consumption.	Relatively simple.	None.
Ability to Pay User charges by private operator can be judged inequitable depending on the fee schedule, since a strict charge according to level of use may not take into account user's ability to pay. *Benefits Received* If user charges are set according to benefits received, no inequities will result.	*Private* Firms might realize greater return by direct investment elsewhere. However, allows private firms to engage in "governmental" activity at a profit. *Public* May reduce public sector costs or expenditures through private provision of services. This depends on the efficiency of the private operator.	Administrative procedures must provide adequate attention to issues such as adequacy of competition, and fair franchise procedures open to public scrutiny.	New uses of licensing may be opposed by public sector employees. U.S. Supreme Court's *Boulder* decision may prompt review of all franchise and licensing authority.

Financing technique	Applicability	Key procedures	Adequacy of funding
Public Sector as Entrepreneur	Potentially available to fund community facilities of any type.	Depends on activity conducted by local agency.	Potentially sufficient.
Sale and Leaseback	*Need Class* 1981 Federal tax legislation specifically authorized use for transit rolling stock. Also applicable to other areas. *New Facilities or Maintenance of Existing Facilities?* New and existing facilities; maintenance can be part of leaseback arrangements. *Government Unit Type* Transit districts; charter cities; and other special districts. Limited applicability in general law cities and counties because of limited authority to undertake tax-axempt debt financing.	• School districts have limited authority to enter into lease arrangements for school facilities under Education Code. • Transit districts have special provisions under 1981 Federal tax legislation to sell bonds for leasing purposes. • Public jurisdictions can negotiate traditional sale and lease arrangements with the private sector, which receives tax advantages.	Sufficient so long as costs of facilities are carefully documented in initial arrangements. Whether enough funds can be raised is heavily dependent on degree to which private firms can be induced to participate in leaseback arrangements.

Equity	Economic effects	Ease of public administration	Legal constraints and opportunities
Ability to Pay May be inequitable if public agency does not address in design of entrepreneurial program. *Benefits Received* For activities where public/private bargaining occurs, revenues generated may be related to benefits derived by private sector.	*Private* May reduce private sector profits somewhat. *Public* Depending on activity, may cause business choices to locate in other jurisdictions, improving economic base there.	Highly dependent on activity chosen.	Few constraints on local agencies unless specific activities are prohibited by local charters.
Ability to Pay Firms acquiring assets must have sufficient capital to do so or will not participate. *Benefits Received* Direct Federal tax writeoffs for firms.	*Private* Firms might realize greater return by direct investment elsewhere. Foregone investment return might be offset by nonquantifiable benefits to firm for exercise of corporate social responsibility, e.g., public attitudes toward firm, increased productivity of workers using improved public facilities. *Public* Essentially a tax expenditure approach to financing facilities by shifting resources to the local level at expense to Federal treasury. Use could give certain regions a slight competitive advantage over others with respect to availability of transit services. Administrative costs likely to range from 1% to 10% of transaction.	Financial and administrative arrangements must be negotiated.	Sale leaseback is an available option under current State and Federal law. Special provisions of the 1981 Federal tax act provide specific advantages for transit rolling stock.

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